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BUREAU OF INTERNAL REVENUE

REGULATIONS 74

INCOME TAX

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REGULATIONS 74

RELATING TO THE

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DIVISION I—INTRODUCTORY PROVISIONS

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act, divided into titles and sections according to the following Table of Contents, may be cited as the "Revenue Act of 1928": (See Table of Contents, pp. V–XXIV.)

TITLE I—INCOME TAX

SUBTITLE A—INTRODUCTORY PROVISIONS

SECTION 1. APPLICATION OF TITLE.

The provisions of this title shall apply only to the taxable year 1928 and succeeding taxable years. Income, war-profits, and excess-profits taxes for taxable years preceding the taxable year 1928 shall not be affected by the provisions of this title, but shall remain subject to the applicable provisions of prior revenue Acts, except as such provisions are modified by Titles III, IV, and V of this Act or by legislation enacted subsequent to this Act.

SEC. 2. CROSS REFERENCES.

The cross references in this title to other portions of the title, where the word "see" is used, are made only for convenience, and shall be given no legal effect.

SEC. 3. CLASSIFICATION OF PROVISIONS.

The provisions of this title are herein classified and designated as—

Subtitle A—Introductory provisions,

Subtitle B—General provisions, divided into Parts and sections,

Subtitle C—Supplemental provisions, divided into Supplements and sections.

SEC. 4. SPECIAL CLASSES OF TAXPAYERS.

The application of the General Provisions and of Supplements A to D, inclusive, to each of the following special classes of taxpayers, shall be subject to the exceptions and additional provisions found in the Supplement applicable to such class, as follows:

(a) Estates and trusts and the beneficiaries thereof—Supplement E.

(b) Members of partnerships—Supplement F.

(c) Insurance companies—Supplement G.

(d) Nonresident alien individuals—Supplement H.

(e) Foreign corporations—Supplement I.

(f) Individual citizens of any possession of the United States who are not otherwise citizens of the United States and who are not residents of the United States—Supplement J.

(g) Individual citizens of the United States or domestic corporations, satisfying the conditions of section 251 by reason of deriving a large portion of their gross income from sources within a possession of the United States—Supplement J.

(h) China Trade Act corporations—Supplement K.

ARTICLE 1. **Division of Regulations.**—These regulations under the income tax provisions of the Revenue Act of 1928[1] consist of four divisions as follows:

Division I, entitled "Introductory Provisions," relating to Introductory Provisions, Subtitle A of Title I.

Division II, entitled "General Provisions," relating to General Provisions, Subtitle B of Title I.

Division III, entitled "Supplemental Provisions," relating to Supplemental Provisions, Subtitle C of Title I.

Division IV, entitled "Miscellaneous Provisions," relating to certain provisions of Titles IV and V.

The application of the articles under Division II and the application of the articles under Division III relating to Supplements A–D of the Act, to certain special classes of taxpayers is subject to the exceptions and additional provisions in Supplements E–K of the Act and in the articles under Division III relating to those Supplements. The special classes of taxpayers, and the Supplements, sections of the Act, and articles of the Regulations containing such exceptions and additional provisions are stated in the following table:

Class of taxpayer	Supplement of Subtitle C	Sections of Act	Articles of Regulations
Estates and trusts and beneficiaries thereof	E	161–170	861–891
Members of partnerships	F	181–189	901–942
Insurance companies	G	201–208	951–1015
Nonresident alien individuals	H	211–218	1021–1091
Foreign corporations	I	231–238	1101–1121
Citizens of possessions of United States not citizens or residents of the United States; and citizens of United States or domestic corporations deriving a large portion of their gross income from sources within a possession of the United States	J	251, 252	1131–1141
China Trade Act corporations	K	261–264	1151–1154

[1] The principal provisions of the Revenue Act of 1926, the Revenue Act of 1924, and the Revised Statutes relating to income taxes for 1928 and subsequent taxable years are printed in the appendix to these regulations.

DIVISION II—GENERAL PROVISIONS

SUBTITLE B—GENERAL PROVISIONS

PART I—RATES OF TAX

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following:

(a) 1½ per centum of the first $4,000 of the amount of the net income in excess of the credits against net income provided in section 25;

(b) 3 per centum of the next $4,000 of such excess amount; and

(c) 5 per centum of the remainder of such excess amount.

ART. 11. **Income tax on individuals.**—Title I of the Act, which in general is effective January 1, 1928 (see section 65), imposes an income tax on individuals, including a normal tax (sections 11 and 211) and a surtax (section 12). The tax is upon net income which is determined by subtracting the allowable deductions from the gross income. (See generally sections 21–24.) In certain cases credits are allowed against the net income before computing the tax (section 25) and in other cases against the amount of the tax (sections 31–33 and 131). In general the tax is payable upon the basis of returns rendered by persons liable thereto (sections 51, 53, 143, and 217), except that in some instances it is to be paid at the source of the income (section 144). Exceptions and additional provisions applicable to certain special classes of taxpayers are listed in section 4 and article 1. See section 104 as to shareholders of corporations formed or availed of to prevent imposition of surtax. See sections 101, 168, and 186 as to treatment of capital gains and capital losses.

ART. 12. **Normal tax on individual citizens or residents of the United States.**—The normal tax on individual citizens or residents of the United States upon the amount of the net income, as defined in section 21, in excess of the credits provided in section 25 is at the rate of 1½ per cent upon the first $4,000 of such excess, 3 per cent upon the next $4,000, and 5 per cent upon the remainder of the net income. For normal tax on nonresident alien individuals see section 211 and article 1021.

ART. 13. **Citizens or residents of the United States liable to tax.**—In general, citizens of the United States, wherever resident, are liable to the tax, and it makes no difference that they may own no assets within the United States and may receive no income from sources within the United States. Every resident alien individual is liable to the tax, even though his income is wholly from sources outside the United States. As to nonresident alien individuals, see sections 211–218 and articles 1021–1091.

ART. 14. **Who is a citizen.**—Every person born or naturalized in the United States, and subject to its jurisdiction, is a citizen. When any naturalized citizen has left the United States and resided for two years in the foreign country from which he came, or for five years in any other foreign country, it is presumed that he has ceased to be an American citizen. This presumption does not apply, however, to residence abroad while the United States was at war, nor does it apply in the case of individuals born in the United States subject to its jurisdiction. For example, if a Swede, after being naturalized in the United States, returned to Sweden and resided there for two years prior to April 6, 1917, he is presumed once more to be an alien. However, even though an individual born in the United States, subject to its jurisdiction, of either citizen or alien parents, resided in a foreign country for a number of years, he would still be a citizen of the United States, unless he had become naturalized in, or taken an oath of allegiance to, the foreign country of residence or some other foreign state. A foreigner who has filed his declaration of intention of becoming a citizen of the United States but who has not yet received his final citizenship papers is an alien. See articles 1022–1025 for distinction between a resident alien individual and a nonresident alien individual.

SEC. 12. SURTAX ON INDIVIDUALS.

(a) Rates of surtax.—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

Upon a net income of $10,000 there shall be no surtax; upon net incomes in excess of $10,000 and not in excess of $14,000, 1 per centum of such excess.

$40 upon net incomes of $14,000; and upon net incomes in excess of $14,000 and not in excess of $16,000, 2 per centum in addition of such excess.

$80 upon net incomes of $16,000; and upon net incomes in excess of $16,000 and not in excess of $18,000, 3 per centum in addition of such excess.

$140 upon net incomes of $18,000; and upon net incomes in excess of $18,000 and not in excess of $20,000, 4 per centum in addition of such excess.

$220 upon net incomes of $20,000; and upon net incomes in excess of $20,000 and not in excess of $22,000, 5 per centum in addition of such excess.

$320 upon net incomes of $22,000; and upon net incomes in excess of $22,000 and not in excess of $24,000, 6 per centum in addition of such excess.

$440 upon net incomes of $24,000; and upon net incomes in excess of $24,000 and not in excess of $28,000, 7 per centum in addition of such excess.

$720 upon net incomes of $28,000; and upon net incomes in excess of $28,000 and not in excess of $32,000, 8 per centum in addition of such excess.

$1,040 upon net incomes of $32,000; and upon net incomes in excess of $32,000 and not in excess of $36,000, 9 per centum in addition of such excess.

$1,400 upon net incomes of $36,000; and upon net incomes in excess of $36,000 and not in excess of $40,000, 10 per centum in addition of such excess.

$1,800 upon net incomes of $40,000; and upon net incomes in excess of $40,000 and not in excess of $44,000, 11 per centum in addition of such excess.

$2,240 upon net incomes of $44,000; and upon net incomes in excess of $44,000 and not in excess of $48,000, 12 per centum in addition of such excess.

$2,720 upon net incomes of $48,000; and upon net incomes in excess of $48,000 and not in excess of $52,000, 13 per centum in addition of such excess.

$3,240 upon net incomes of $52,000; and upon net incomes in excess of $52,000 and not in excess of $56,000, 14 per centum in addition of such excess.

$3,800 upon net incomes of $56,000; and upon net incomes in excess of $56,000 and not in excess of $60,000, 15 per centum in addition of such excess.

$4,400 upon net incomes of $60,000; and upon net incomes in excess of $60,000 and not in excess of $64,000, 16 per centum in addition of such excess.

$5,040 upon net incomes of $64,000; and upon net incomes in excess of $64,000 and not in excess of $70,000, 17 per centum in addition of such excess.

$6,060 upon net incomes of $70,000; and upon net incomes in excess of $70,000 and not in excess of $80,000, 18 per centum in addition of such excess.

$7,860 upon net incomes of $80,000; and upon net incomes in excess of $80,000 and not in excess of $100,000, 19 per centum in addition of such excess.

$11,660 upon net incomes of $100,000; and upon net incomes in excess of $100,000, in addition 20 per centum of such excess.

(b) Sale of mines and oil or gas wells.—For limitation of surtax attributable to sale of mines and oil or gas wells, see section 102.

(c) Capital net gains and losses.—For rate and computation of tax in lieu of normal and surtax in case of net incomes of not less than

$30,000, approximately, or in case of net incomes, excluding items of capital gain, capital loss, and capital deductions, of not less than $30,000, approximately, see section 101.

(d) **Evasion of surtaxes by incorporation.**—For tax on corporations which accumulate surplus to evade surtax on stockholders, see section 104.

ART. 21. **Surtax.**—In addition to the normal tax imposed by sections 11 and 211 (see articles 11–14 and 1021) a surtax is imposed at the rates specified in section 12 upon the net income of every individual, resident or nonresident. In determining the taxable net income, for the purpose of the surtax, the credits provided by section 25 in the case of the normal tax are not applicable. The tax under section 101 in the case of a capital net gain is in lieu of the normal tax and the surtax. As to limitation on surtax on gain from sale of mines and oil or gas wells, see section 102 and article 511.

ART. 22. **Computation of surtax.**—The following table shows the surtax due for 1928 and subsequent years upon certain specified amounts of net income. In each instance the first figure of the net income in the net-income column is to be excluded and the second figure included. The percentage given opposite applies to the excess of income over the first figure in the net-income column. The last column gives the total surtax on a net income equal to the second figure in the net-income column.

Net income	Per cent	Total surtax
$0 to $10,000		
$10,000 to $14,000	1	$40
$14,000 to $16,000	2	80
$16,000 to $18,000	3	140
$18,000 to $20,000	4	220
$20,000 to $22,000	5	320
$22,000 to $24,000	6	440
$24,000 to $28,000	7	720
$28,000 to $32,000	8	1,040
$32,000 to $36,000	9	1,400
$36,000 to $40,000	10	1,800
$40,000 to $44,000	11	2,240
$44,000 to $48,000	12	2,720
$48,000 to $52,000	13	3,240
$52,000 to $56,000	14	3,800
$56,000 to $60,000	15	4,400
$60,000 to $64,000	16	5,040
$64,000 to $70,000	17	6,060
$70,000 to $80,000	18	7,860
$80,000 to $100,000	19	11,660
$100,000 up	20	

The surtax for any amount of net income not shown in the table is computed by adding to the surtax for the largest amount shown

which is less than the income, the surtax upon the excess over that amount at the rate indicated in the table. Accordingly, the surtax upon a net income of $63,128 would be $4,900.48, computed as follows:

Surtax on $60,000 from table	$4,400.00
Surtax on $3,128 at 16 per cent	500.48
Total	4,900.48

SEC. 13. TAX ON CORPORATIONS.

(a) **Rate of tax.**—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation, a tax of 12 per centum of the amount of the net income in excess of the credits against net income provided in section 26.

(b) **Exempt corporations.**—For corporations exempt from tax, see section 103.

(c) **Improper accumulation of surplus.**—For tax on corporations which accumulate surplus to evade surtax on stockholders, see section 104.

ART. 31. **Income tax on corporations.**—The Act imposes an income tax on all corporations not expressly exempt (see section 103) at the rate of 12 per cent of the net income subject to tax. Every corporation not exempt under section 103 is liable to the tax, and it makes no difference that a domestic corporation may receive no income from sources within the United States. The tax is upon net income, that is, gross income as defined by the Act, less allowable deductions. (See sections 21–24.) Certain credits are allowed against net income and against the amount of the tax. (See sections 26, 131, and 206.) The tax is payable upon the basis of returns rendered by the corporations liable thereto, except that in some cases it is to be paid at the source of the income. (See also sections 47, 52, 53, 145, and 235.) For the income tax on life insurance companies, see sections 201–203; on insurance companies other than life or mutual, section 204. Mutual insurance companies other than life are taxed under section 13. (See section 208.) As to foreign corporations, see sections 53 and 231–238; as to domestic corporations deriving income from sources within possessions of the United States, see section 251; as to China Trade Act corporations, see sections 261–264. For what the term "corporation" includes and for the difference between domestic and foreign corporations, see section 701 (a) (2) and articles 1311–1314, 1316, 1318, and 1319.

SEC. 14. TAXABLE PERIOD EMBRACING YEARS WITH DIFFERENT LAWS.

If a taxable period embraces portions of two calendar years for which the laws are different, the tax shall be computed as provided in section 105.

PART II—COMPUTATION OF NET INCOME

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

ART. 41. **Meaning of net income.**—The tax imposed by the Act is upon income. In the computation of the tax various classes of income must be considered:

(*a*) Income (in the broad sense), meaning all wealth which flows in to the taxpayer other than as a mere return of capital. It includes the forms of income specifically described as gains and profits, including gains derived from the sale or other disposition of capital assets. Cash receipts alone do not always accurately reflect income, for the Act recognizes as income-determining factors other items, among which are inventories, accounts receivable, property exhaustion, and accounts payable for expenses incurred. (See sections 22, 23, and 101 and the articles thereunder.)

(*b*) Gross income, meaning income (in the broad sense) less income which is by statutory provision or otherwise exempt from the tax imposed by the Act. (See section 22 and the articles thereunder.)

(*c*) Net income, meaning gross income less statutory deductions. The statutory deductions are in general, though not exclusively, expenditures, other than capital expenditures, connected with the production of income. (See sections 23 and 24 and the articles thereunder.)

(*d*) Net income less credits. (See sections 25 and 26 and the articles thereunder.)

The surtax on individuals is imposed upon net income; the normal tax on individuals and the tax upon corporations is imposed upon net income less credits. Although taxable net income is a statutory conception, it follows, subject to certain modifications as to exemptions and as to deductions for partial losses in some cases, the lines of commercial usage. Subject to these modifications statutory net income is commercial net income. This appears from the fact that ordinarily it is to be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. (See section 41.)

The net income of corporations is determined in general in the same manner as the net income of individuals, but the deductions allowed corporations are not precisely the same as those allowed individuals. (See sections 23, 24, 117, 118, 203, 204, 208, and 232 and the articles thereunder.)

SEC. 22. GROSS INCOME.

(a) General definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

ART. 51. **What included in gross income.**—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. Profits of citizens, residents, or domestic corporations derived from sales in foreign commerce must be included in their gross income; but special provisions are made for nonresident aliens by sections 212–215 and in certain cases for citizens and domestic corporations deriving income from sources within possessions of the United States by section 251. Income may be in the form of cash or of property. As to dividends, whether in cash or in property, see section 115 and articles 621–629.

Where property is sold by a corporation to a shareholder, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition by the shareholder or the employee. This paragraph does not apply, however, to the issuance by a corporation to its shareholders of the right to subscribe to its stock, as to which see article 58.

In the case of stock sold between dividend dates, the entire amount of the dividend is income to the vendee and must be reported in his gross income when the dividend becomes due and payable. The amount advanced by the vendee to the vendor in contemplation of the next dividend payment is an investment of capital and may not be claimed as a deduction from gross income. As to the amount of income tax paid for a bondholder by the obligor pursuant to a so-called tax-free covenant, see section 144 (a) (4). As to the determi-

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nation of gain or loss from sale or disposition of property, see sections 111–113 and articles 561–604.

As to insurance companies and foreign corporations, see sections 202, 204, 207, 208, and 231 and articles 961, 992, 1001, 1101, and 1102.

ART. 52. **Compensation for personal services.**—Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, pay of persons in the military or naval forces of the United States, retired pay of Federal and other officers, and pensions or retiring allowances paid by private persons or by the United States (except pensions exempted by section 22 (b) (6)), are income to the recipients; as are also marriage fees, baptismal offerings, sums paid for saying masses for the dead, and other contributions received by a clergyman, evangelist, or religious worker for services rendered. However, so-called pensions awarded by one to whom no services have been rendered are mere gifts or gratuities and are not taxable. The salaries of Federal officers and employees are subject to tax. But see section 116 (a). See section 31 and articles 311 and 312 for special provisions relative to credit against the tax on account of earned income, and article 643 as to compensation of State officers and employees.

ART. 53. **Compensation paid other than in cash.**—Where services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received. Compensation paid an employee of a corporation in its stock is to be treated as if the corporation sold the stock for its market value and paid the employee in cash. When living quarters such as camps are furnished to employees for the convenience of the employer, the ratable value need not be added to the cash compensation of the employees, but where a person receives as compensation for services rendered a salary and in addition thereto living quarters, the value to such person of the quarters furnished constitutes income subject to tax. The value of quarters furnished Army and Navy officers, members of the Coast Guard, Coast and Geodetic Survey, and Public Health Service, or amounts received as commutation of quarters by such officers or members, do not constitute taxable income. (See also section 22 (b) (8).) Premiums paid by an employer on policies of group life insurance covering the lives of his employees, the beneficiaries of which are designated by the employees, are not income to the employees. (See article 283.)

ART. 54. **Compensation paid in notes.**—Notes or other evidences of indebtedness received in payment for services, and not merely as security for such payment, constitute income to the amount of their fair market value. A taxpayer receiving as compensation a note regarded as good for its face value at maturity, but not bearing interest, shall treat as income as of the time of receipt the fair discounted value of the note at such time. Thus, if it appears that such a note is or could be discounted on a 6 per cent basis, the recipient shall include such note in his gross income to the amount of its face value less discount computed at the prevailing rate for such transactions. If the payments due on a note so accounted for are met as they become due, there should be included as income in respect of each such payment so much thereof as represents recovery for the discount originally deducted.

ART. 55. **Gross income from business.**—In the case of a manufacturing, merchandising, or mining business "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. In determining the gross income subtractions should not be made for depreciation, depletion, selling expenses, or losses, or for items not ordinarily used in computing the cost of goods sold.

ART. 56. **State contracts.**—The profit of an independent contractor from a contract with a State or political subdivision thereof must be included in gross income. Where warrants are issued by a city, town, or other political subdivision of a State, and are accepted by the contractor in payment for public work done, the fair market value of such warrants should be returned as income. If for any reason the contractor upon conversion of the warrants into cash does not receive and can not recover the full value of the warrants so returned, he may deduct from gross income for the year in which the warrants are converted into cash any loss sustained, and if he realizes more than the value of the warrants so returned he should include such amount in his gross income of the year in which realized.

ART. 57. **Gross income of farmers.**—A farmer reporting on the basis of receipts and disbursements (in which no inventory to determine profits is used) shall include in his gross income for the taxable year (1) the amount of cash or the value of merchandise or other property received from the sale of live stock and produce which were raised during the taxable year or prior years, (2) the profits from the sale of any live stock or other items which were purchased, and (3) gross income from all other sources. The profit from the sale of live stock or other items which were purchased after February 28, 1913, is to be ascertained by deducting the cost from the sales price in the year in

which the sale occurs, except that in the case of the sale of animals purchased as draft or work animals or solely for breeding or dairy purposes and not for resale, the profit shall be the amount of any excess of the sales price over the amount representing the difference between the cost and the depreciation theretofore allowable in respect of such property as a deduction in computing net income.

In the case of a farmer reporting on the accrual basis (in which an inventory is used to determine profits), his gross profits are ascertained by adding to the inventory value of live stock and products on hand at the end of the year the amount received from the sale of live stock and products, and miscellaneous receipts for hire of teams, machinery, and the like, during the year, and deducting from this sum the inventory value of live stock and products on hand at the beginning of the year and the cost of live stock and products purchased during the year. In such cases all live stock raised or purchased for sale shall be included in the inventory at their proper valuation determined in accordance with the method authorized and adopted for the purpose. Also live stock acquired for draft, breeding, or dairy purposes and not for sale may be included in the inventory, instead of being treated as capital assets subject to depreciation, provided such practice is followed consistently by the taxpayer. In case of the sale of any live stock included in an inventory their cost must not be taken as an additional deduction in the return of income, as such deduction will be reflected in the inventory. (See article 106.)

In every case of the sale of machinery, farm equipment, or other capital assets purchased after February 28, 1913 (which are not to be included in an inventory if one is used to determine profits), any excess over the cost thereof less the amount of depreciation theretofore allowable in respect of such property as a deduction in computing net income, shall be included as gross income. Where farm produce is exchanged for merchandise, groceries, or the like, the market value of the article received in exchange is to be included in gross income. Rents received in crop shares shall be returned as of the year in which the crop shares are reduced to money or a money equivalent. Proceeds of insurance, such as hail and fire insurance on growing crops, should be included in gross income to the amount received in cash or its equivalent for the crop injured or destroyed. If a farmer is engaged in producing crops which take more than a year from the time of planting to the time of gathering and disposing, the income therefrom may be computed upon the crop basis; but in any such cases the entire cost of producing the crop must be taken

as a deduction in the year in which the gross income from the crop is realized.

As herein used the term "farm" embraces the farm in the ordinarily accepted sense, and includes stock, dairy, poultry, fruit, and truck farms; also plantations, ranches, and all land used for farming operations. All individuals, partnerships, or corporations that cultivate, operate, or manage farms for gain or profit, either as owners or tenants, are designated farmers. A person cultivating or operating a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer.

Form 1040 F should be filled in and attached to his income tax return by every farmer who either keeps no records or only records of cash receipts and disbursements; its use is optional with other farmers. (See further articles 131, 175, and 210.)

ART. 58. **Sale of stock and rights.**—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots can not be determined, the stock sold shall be charged against the earliest purchases of such stock. The excess of the amount realized on the sale over the cost or other basis of the stock will constitute gain. In the case of stock in respect of which any stock dividend was paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained in accordance with the principles laid down in article 600. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost.

Where a corporation issues to its shareholders rights to subscribe to its stock, the value of the rights does not constitute taxable income to the shareholder, although gain may be derived or loss sustained by the shareholder from the sale of such rights. In this connection the following rules may be stated:

(1) If the shareholder does not exercise, but sells his rights to subscribe, the cost or other basis of the stock in respect of which the rights are issued shall be apportioned between the rights and the stock in proportion to the respective values thereof at the time the rights are issued, and the basis for determining gain or loss from the sale of a right on one hand or a share of stock on the other

will be the quotient of the cost or other basis assigned to the rights or the stock, divided, as the case may be, by the number of rights issued or by the number of shares held.

Example: A taxpayer in 1927 purchased 500 shares of stock at $125 a share, and in 1928, by reason of the ownership of such stock, received 500 rights entitling him to subscribe to 100 additional shares at $100 a share. Upon the issuance of the rights each of the shares of stock in respect of which the rights were issued had a fair market value of $120, and the rights had a fair market value of $3 each. Instead of subscribing to the additional shares, A sold the rights at $4 each. The profit is computed as follows:

500 (shares) × $125 = $62,500, cost of old stock (stock in respect of which the rights were issued)

500 (shares) × $120 = $60,000, market value of old stock

500 (rights) × $3 = $1,500, market value of rights

$\frac{60,000}{61,500}$ of $62,500 = $60,975.61, cost of old stock apportioned to such stock after issuance of rights

$\frac{1,500}{61,500}$ of $62,500 = $1,524.39, cost of old stock apportioned to rights

$2,000 (proceeds of sale of rights) less $1,524.39 (cost of old stock apportioned to rights) = $475.61, profit

For the purpose of determining the gain or loss from the subsequent sale of the stock in respect of which the rights were issued, the adjusted cost of each share is $121.95—that is, $60,975.61 ÷ 500.

(2) If the shareholder exercises his rights to subscribe, the basis for determining gain or loss from a subsequent sale of a share of the stock in respect of which the rights were issued shall be determined as in paragraph (1). The basis for determining gain or loss from a subsequent sale of a share of the stock obtained through exercising the rights shall be determined by dividing the part of the cost or other basis of the old shares assigned to the rights, plus the subscription price of the new shares, by the number of new shares obtained.

Example: A taxpayer in 1927 purchased 500 shares of stock at $125 a share, and in 1928, by reason of the ownership of such stock, received 500 rights entitling him to subscribe to 100 additional shares at $100 a share. Upon the issuance of the rights each of the shares of stock in respect of which the rights were issued had a fair market value of $120, and the rights had a fair market value of $3 each. The taxpayer exercised his rights to subscribe to the additional shares and later sold one of such shares for $140. The profit is computed as follows:

$1,524.39 (cost of old stock apportioned to rights pursuant to the computation in the example under paragraph (1)) + $10,000 (subscription price of additional shares) = $11,524.39, basis for determining gain or loss from sale of additional shares

$11,524.39 ÷ 100 = $115.24, basis for determining gain or loss from sale of each share of additional stock

$140 (proceeds of sale of share of additional stock) less $115.24 = $24.76, profit

The basis for determining the gain or loss from subsequent sale of the stock in respect of which the rights were issued is $60,975.61 ÷ 500, or $121.95 a share.

If the stock in respect of which the rights are issued was purchased at different times and at different prices and the identity of the lots can not be determined, or if the stock in respect of which the rights are issued was purchased at different times and at different prices and the stock rights issued in respect of such stock can not be identified as having been issued in respect of any particular lot of such stock, the basis for determining the gain or loss from the sale of the old shares or the rights in cases where the rights are sold or from the sale of the old or new shares in cases where the rights are exercised, shall be ascertained in accordance with the principles laid down in article 600.

The taxpayer may at his option include the entire proceeds from the sale of stock rights in gross income, in which case the basis for determining gain or loss from the subsequent sale of the stock in respect of which the rights were issued shall be the same as though the rights had not been issued.

ART. 59. **Sale of patents and copyrights.**—A taxpayer disposing of patents or copyrights by sale should determine the gain or loss arising therefrom by computing the difference between the selling price and the cost or other basis, with proper adjustment for depreciation, as provided in article 561. (See also article 207.)

ART. 60. **Sale of good will.**—Gain or loss from a sale of good will results only when the business, or a part of it, to which the good will attaches is sold, in which case the gain or loss will be determined by comparing the sale price with the cost or other basis of the assets, including good will. (See article 561.) If specific payment was not made for good will acquired after February 28, 1913, there can be no deductible loss with respect thereto, but gain may be realized from the sale of good will built up through expenditures which have been currently deducted. It is immaterial that good will may never have been carried on the books as an asset, but

the burden of proof is on the taxpayer to establish the cost or fair market value on March 1, 1913, of the good will sold.

ART. 61. **Sale of real property in lots.**—Where a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the cost or other basis shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels which constitutes taxable income may be returned as income for the year in which the sale is made. This rule contemplates that there will be a measure of gain or loss on every lot or parcel sold, and not that the capital in the entire tract shall be recovered before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction, and gain or loss computed accordingly. As to deductions for future expense liabilities, see section 23 (o).

ART. 62. **Annuities and insurance policies.**—Annuities paid by religious, charitable, and educational corporations under an annuity contract are, in general, subject to tax to the extent that the aggregate amount of the payments to the annuitant exceeds the amounts paid as consideration for the contract. But see section 22 (b) (2) and article 82. An annuity charged upon devised land is taxable to a donee-annuitant, whether paid by the devisee out of the rents of the land or from other sources. The devisee is not required to return as gross income the amount of rent paid to the annuitant, and he is not entitled to deduct from his gross income any sums paid to the annuitant. Amounts received by an insured as a return of premiums paid by him under life insurance, endowment, or annuity contracts, such as the so-called "dividend" of a mutual insurance company which may be credited against the current premium, are not subject to tax.

ART. 63.[1] **Improvements by lessees.**—When buildings are erected or improvements made by a lessee in pursuance of an agreement with the lessor, and such buildings or improvements are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon either of the following bases:

(*a*) The lessor may report as income at the time when such buildings or improvements are completed the fair market value of such buildings or improvements subject to the lease.

(*b*) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the termination of the lease and report as income for each year of the lease an aliquot part thereof.

[1] See T. D. 4282, p. 347.

If for any other reason than a bona fide purchase from the lessee by the lessor the lease is terminated, so that the lessor comes into possession or control of the property prior to the time originally fixed for the termination of the lease, the lessor receives additional income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he became entitled to such possession exceeds the amount already reported as income on account of the erection of such buildings or improvements. No appreciation in value due to causes other than the premature termination of the lease shall be included. Conversely, if the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less any salvage value subject to the lease to the extent that such loss was not compensated for by insurance. If the buildings or improvements destroyed were acquired prior to March 1, 1913, the deduction shall be based on the cost or the value subject to the lease as of that date, whichever is higher, less any salvage value subject to the lease to the extent that such loss was not compensated for by insurance. (See articles 130 and 204.)

ART. 64. **Forgiveness of indebtedness.**—The cancellation and forgiveness of indebtedness may amount to a payment of income, to a gift, or to a capital transaction, dependent upon the circumstances. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income to that amount is realized by the debtor as compensation for his services. If, however, a creditor merely desires to benefit a debtor and without any consideration therefor cancels the debt, the amount of the debt is a gift from the creditor to the debtor and need not be included in the latter's gross income. If a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation.

ART. 65. **Creation of sinking fund by corporation.**—If a corporation, in order solely to secure the payment of its bonds or other indebtedness, places property in trust or sets aside certain amounts in a sinking fund under the control of a trustee who may be authorized to invest and reinvest such sums from time to time, the property or fund thus set aside by the corporation and held by the trustee is an asset of the corporation, and any gain arising therefrom is income of the corporation and shall be included as such in its annual return.

ART. 66. **Sale by corporation of its capital stock.**—The proceeds from the original sale by a corporation of its shares of capital stock,

whether such proceeds are in excess of or less than the par value of the stock issued, constitute the capital of the company. If the stock is sold at a premium, the premium is not income. Likewise, if the stock is sold at a discount, the amount of the discount is not a loss deductible from gross income. If, for the purpose of enabling a corporation to secure working capital or for any other purpose, the shareholders donate or return to the corporation to be resold by it certain shares of stock of the company previously issued to them, or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock. (See article 176.)

ART. 67. **Contributions to corporation by shareholders.**—Where a corporation requires additional funds for conducting its business and obtains such needed money through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special capital account, such amounts will not be considered income, although there is no increase in the outstanding shares of stock of the corporation. The payments in such circumstances are in the nature of voluntary assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. (See articles 64 and 282.)

ART. 68. **Sale and retirement by corporation of its bonds.**—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (*a*) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or

over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

ART. 69. **Sale of capital assets by corporation.**—Where property is acquired and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. Where, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the gain from such sale computed as provided in sections 111–113 and articles 561–604. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the selling price.

ART. 70. **Income to lessor corporation from leased property.**—Where a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made by the lessee

directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

ART. 71. **Gross income of corporation in liquidation.**—When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298 and articles 1191 and 1192.) Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. But see section 44 (d) and article 355. (See further article 392.)

[SEC. 22. GROSS INCOME.]

(b) **Exclusions from gross income.**—The following items shall not be included in gross income and shall be exempt from taxation under this title:

(1) LIFE INSURANCE.—Amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or in installments (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income);

(2) ANNUITIES, ETC.—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or this paragraph;

(3) GIFTS, BEQUESTS, AND DEVISES.—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

(4) TAX-FREE INTEREST.—Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its

possessions. Every person owning any of the obligations or securities enumerated in clause (A), (B), or (C) shall, in the return required by this title, submit a statement showing the number and amount of such obligations and securities owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income taxes;

(5) COMPENSATION FOR INJURIES OR SICKNESS.—Amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness;

(6) PENSIONS AND WORLD WAR COMPENSATION PAYMENTS.—Amounts received as compensation, family allotments and allowances under the provisions of the War Risk Insurance and the Vocational Rehabilitation Acts or the World War Veterans' Act, 1924, or as pensions from the United States for service of the beneficiary or another in the military or naval forces of the United States in time of war, or as a State pension for services rendered by the beneficiary or another for which the State is paying a pension;

(7) BUILDING AND LOAN ASSOCIATIONS.—The amount received by an individual as dividends or interest from domestic building and loan associations, substantially all the business of which is confined to making loans to members, but the amount excluded from gross income under this paragraph in any taxable year shall not exceed $300;

(8) MINISTERS.—The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

(9) MISCELLANEOUS ITEMS.—The following items, to the extent provided in section 116:

Earned income from sources without the United States;
Salaries of certain Territorial employees;
The income of foreign governments;
Income of States, municipalities and other political subdivisions;
Receipts of ship owners' mutual protection and indemnity associations;
Dividends from China Trade Act corporations.

ART. 81. **Exclusions from gross income.**—The term "gross income" as used in the Act does not include those items of income exempted by statute or by fundamental law. The exemption of such income should not be confused with the reduction of taxable income by the

application of allowable deductions. Every person owning obligations of a State, Territory, any political subdivision thereof, or the District of Columbia; securities issued under the provisions of the Federal Farm Loan Act or of such Act as amended; or obligations of the United States or its possessions, must, however, submit in his income tax return a statement showing the number and amount of such obligations and securities owned and the income received therefrom. For additional exclusions from gross income, see section 116 and articles 641–643.

ART. 82. **Proceeds of insurance—Compensation—Pensions.**—The proceeds of life insurance policies, paid by reason of the death of an insured to his estate or to any beneficiary (individual, partnership, or corporation, but not a transferee for a valuable consideration), directly or in trust, are excluded from the gross income of the beneficiary. It is immaterial whether the proceeds are received in a single sum or in installments. If, however, such proceeds are held by the insurer under an agreement to pay interest thereon, the interest payments must be included in gross income. Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts) under a life insurance, endowment, or annuity contract are excluded from gross income, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. (See article 62.) However, in the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee are exempt from taxation. The amounts received by an insured or his estate or other beneficiaries through accident or health insurance or under workmen's compensation acts as compensation for personal injuries or sickness are excluded from the gross income of the insured, his estate, and other beneficiaries. Any damages recovered by suit or agreement on account of such injuries or sickness are similarly excluded from the gross income of the individual injured or sick, if living, or of his estate or other beneficiaries entitled to receive such damages, if dead. (See further article 283.) Since June 25, 1918, no assessment of any Federal tax may be made on any allotments, family allowances, compensation, or death or disability insurance payable under the War Risk Insurance Act of September 2, 1914, as amended, even though the benefit accrued before that date. In addition to this exemption from all Federal taxes, the Revenue Act of 1928 exempts from income tax

amounts received as compensation, family allotments, and allowances under the provisions of the War Risk Insurance Act, the Vocational Rehabilitation Act, or the World War Veterans' Act, 1924, or as pensions from the United States for service of the beneficiary or another in the military or naval forces of the United States in time of war, or as a State pension for services rendered by the beneficiary or another for which the State is paying a pension. As to meaning of "military and naval forces of the United States," see section 701 (a) (14).

ART. 83. **Gifts and bequests.**—Property received as a gift, or received under a will or under statutes of descent and distribution, is exempt from the income tax, although the income therefrom derived from investment, sale, or otherwise is not. An amount of principal paid under a marriage settlement is a gift. Neither alimony nor an allowance based on a separation agreement is taxable income. (See article 281.)

ART. 84. **Interest upon State obligations.**—Interest upon the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia is exempt from the income tax. Obligations issued by or on behalf of the State or Territory or a duly organized political subdivision acting by constituted authorities empowered to issue such obligations, are the obligations of a State or Territory or a political subdivision thereof. The term "political subdivision" denotes any division of the State or Territory made by the proper authorities thereof acting within their constitutional powers. Political subdivisions of a State or Territory, within the meaning of the exemption, include special assessment districts so created, such as road, water, sewer, gas, light, reclamation, drainage, irrigation, levee, school, harbor, port improvement, and similar districts and divisions of a State or Territory.

ART. 85. **Dividends and interest from Federal land banks, Federal intermediate credit banks, and national farm-loan associations.**—As section 26 of the Federal Farm Loan Act of July 17, 1916 (39 Stat., 360), as amended by an Act approved March 4, 1923 (42 Stat., 1454), provides that Federal land banks, Federal intermediate credit banks, and national farm-loan associations, including the capital and reserve or surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate, and that first mortgages executed to Federal land banks, Federal intermediate credit banks, or to joint stock land banks, and farm-loan bonds, and debentures issued by intermediate credit banks, with the income therefrom, shall be exempt from taxation, the income derived from dividends on stock of Federal land banks, Federal intermediate credit banks,

and national farm-loan associations and from interest on promissory notes secured by such first mortgages, or from such farm-loan bonds or debentures, is not subject to the income tax.

ART. 86. **Dividends from Federal reserve banks.**—Section 7 of the Federal Reserve Act of December 23, 1913, provides that Federal reserve banks, including the capital stock and surplus therein and the income derived therefrom, shall be exempt from taxation, except taxes upon real estate. This exemption attaches to and follows the income derived from dividends on stock of Federal reserve banks in the hands of the shareholders, so that the dividends received on the stock of Federal reserve banks are not subject to the income tax. Dividends paid by member banks, however, are treated like dividends of ordinary corporations.

ART. 87.[1] **Interest upon United States obligations.**—Although interest upon the obligations of the United States and its possessions is generally exempt from tax, in the case of obligations issued by the United States after September 1, 1917, which include Treasury certificates of indebtedness, Treasury bonds, Treasury savings certificates, the Liberty bond issues (except the first Liberty loan 3½ per cent bonds), and Treasury notes, the interest is exempt from tax only if and to the extent provided in the Acts authorizing the issue thereof, as amended and supplemented. The interest on all these obligations is exempt from the normal income tax.

Interest on the first Liberty loan 3½ per cent bonds is entirely exempt from Federal, State, and local taxation, except estate or inheritance taxes, but this absolute exemption does not extend to the bonds of the first Liberty loan converted (Liberty 4 per cent and 4¼ per cent bonds).

Liberty 4 per cent and 4¼ per cent bonds, Treasury bonds, Treasury certificates of indebtedness, Treasury savings certificates, and Treasury notes are exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (*a*) estate or inheritance taxes, and (*b*) surtaxes and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations.

Liberty 4 per cent and 4¼ per cent bonds, Treasury bonds, Treasury certificates of indebtedness, and Treasury savings certificates are entitled to a limited exemption from surtaxes and excess-profits taxes now or hereafter imposed by the United States. Interest on an aggregate of not exceeding $5,000 principal amount of these obligations is exempt from the surtax imposed by section 12. Interest in excess of the interest on an aggregate of not exceeding $5,000 principal amount of such obligations is subject to surtax and must be included in gross income. This limited exemption does not apply to the interest on Treasury notes.

[1] See T. Ds. 4276 and 4292, pp. 348, 351.

Interest credited to postal savings accounts upon moneys deposited in postal savings banks is wholly exempt from income tax.

ART. 88. **Exemption of Treasury savings certificates.**—Treasury savings certificates are issued under the Second Liberty Bond Act of September 24, 1917, as amended. Such certificates are not transferable, nor is it lawful for any one person at any one time to hold more than $5,000, maturity value, of any one series thereof. The principal amount of such certificates for the purpose of computing the exemption is their issue price.

In the case of a taxpayer reporting income on the basis of cash receipts and disbursements, the difference between the issue price of the savings certificates and the amount received upon their redemption is deemed to be income to the holder in the taxable year when received. The amount thus received is exempt from all State and local taxation (except estate and inheritance taxes) and from the normal Federal income tax and the corporation income tax. It is not exempt from surtaxes, except to the extent that it falls within the exemption described in article 87, in respect of the interest on an aggregate principal amount of 4 and 4¼ per cent Liberty bonds, Treasury bonds, Treasury certificates of indebtedness, and Treasury savings certificates, not exceeding $5,000. For the purpose of computing this limited exemption, savings certificates are to be taken at issue price, and if the exemption is claimed with respect to any holdings of savings certificates it will be deemed to cover the period during which the taxpayer holds the savings certificates in respect of which the exemption is claimed, and not merely the taxable year in which the certificates are redeemed. In other words, if the taxpayer holds and claims exemption upon $4,000 (issue price) of savings certificates of the Series 1924, for the full period of 5 years to maturity, he will not be allowed any exemption with respect to any other holdings in excess of $1,000 of 4 and 4¼ per cent Liberty bonds, Treasury bonds, and Treasury certificates of indebtedness or savings certificates under the $5,000 limited exemption described in article 87 for any part of the five-year period. If, on the other hand, the holder of $4,000 (issue price) of savings certificates, Series 1924, has during the prior four years taken the full benefit of the $5,000 limited exemption with respect to other holdings of bonds or certificates, he

will not be allowed exemption in the fifth year for more than the amount by which the maturity value of the savings certificates exceeds the published redemption price at the beginning of that year.

In the case of a taxpayer reporting on the accrual basis, the interest to be reported for each year is the excess of the published redemption price of the certificates at the end of his accounting year, or of the amount received upon redemption, if redeemed during the year, over the corresponding published price for the beginning of that year; and the interest exempt from taxation, if any, is the proportion of the interest accrued that the portion of the issue price includible in the exemption for each year is of the total issue price.

ART. 89. **Liberty loan bond exemption in the case of trusts or partnerships.**—(*a*) When the income of a trust is taxable to beneficiaries, as in the case of a trust the income of which is to be distributed to the beneficiaries currently, each beneficiary is entitled to exemption as if he owned directly a proportionate part of the Liberty loan bonds held in trust. When, on the other hand, income is taxable to the trustee, as in the case of a trust the income of which is accumulated for the benefit of unborn or unascertained persons, the trust, as the owner of the bonds held in trust, is entitled to the exemption on account of such ownership.

(*b*) As the income of a partnership is taxable to the individual partners, each partner is entitled to exemption as if he owned directly a proportionate part of the bonds held by the partnership.

ART. 90. **Interest upon United States obligations in the case of nonresident aliens and certain foreign organizations.**—By virtue of section 4 of the Victory Liberty Loan Act of March 3, 1919, amending section 3 of the Fourth Liberty Bond Act of July 9, 1918, the interest received on and after March 3, 1919, on bonds, notes, and certificates of indebtedness of the United States while beneficially owned by a nonresident alien individual, or a foreign corporation, partnership, or association, not engaged in business in the United States, is exempt from income taxes.

ART. 91. **Income accrued prior to March 1, 1913.**—Any claim existing unconditionally on March 1, 1913, whether presently payable or not, and held by a taxpayer prior to March 1, 1913, whether evidenced by writing or not, and all interest which had accrued thereon before that date, do not constitute taxable income, although actually recovered or received subsequent to such date. Interest accruing on or after that date is taxable income. Where an interest-bearing claim held on February 28, 1913, is paid in whole or in part after that date, any gain derived from the payment of the claim is taxable.

The amount of such gain is the excess of the proceeds of the claim (both principal and interest) exclusive of any interest accrued since February 28, 1913, already returned as income, over the cost thereof (both principal and interest then accrued). However, the gain to be included in gross income where the fair market value of the claim as of March 1, 1913, is greater than the cost thereof, is the excess of the amount received over such value. In the case of an insurance policy its surrender value as of March 1, 1913, may be used as a basis for the purpose of ascertaining the gain derived from its sale or other disposition. Where services were rendered prior to March 1, 1913, but paid for thereafter, the amount received is taxable income to the extent of the excess of such amount over the fair market value on March 1, 1913, of the principal of the claim and any interest which had then accrued.

[SEC. 22. GROSS INCOME.]

(c) **Inventories.**—Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

ART. 101. **Need of inventories.**—In order to reflect the net income correctly, inventories at the beginning and end of each year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption, or use in productive processes, together with all finished or partly finished goods. Only merchandise title to which is vested in the taxpayer should be included in the inventory. Accordingly, the seller should include in his inventory goods under contract for sale but not yet segregated and applied to the contract and goods out upon consignment, but should exclude from inventory goods sold, title to which has passed to the purchaser. A purchaser should include in inventory merchandise purchased, title to which has passed to him, although such merchandise is in transit or for other reasons has not been reduced to physical possession, but should not include goods ordered for future delivery, transfer of title to which has not yet been effected. Taxpayers are not required to file with their returns for 1928 and subsequent taxable years certificates of inventory on Form 1126.

ART. 102. **Valuation of inventories.**—Section 22 (c) provides two tests to which each inventory must conform:

(1) It must conform as nearly as may be to the best accounting practice in the trade or business, and

(2) It must clearly reflect the income.

It follows, therefore, that inventory rules can not be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order clearly to reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is substantially in accord with these regulations. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.

The bases of valuation most commonly used by business concerns and which meet the requirements of section 22 (c) are (*a*) cost and (*b*) cost or market, whichever is lower. (For inventories by dealers in securities, see article 105.) Any goods in an inventory which are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued at bona fide selling prices less cost of selling, whether basis (*a*) or (*b*) is used, or if such goods consist of raw materials or partly finished goods held for use or consumption, they shall be valued upon a reasonable basis, taking into consideration the usability and the condition of the goods, but in no case shall such value be less than the scrap value. Bona fide selling price means actual offering of goods during a period ending not later than 30 days after inventory date. The burden of proof will rest upon the taxpayer to show that such exceptional goods as are valued upon such selling basis come within the classifications indicated above, and he shall maintain such records of the disposition of the goods as will enable a verification of the inventory to be made.

In respect to normal goods, whichever basis is adopted must be applied with reasonable consistency to the entire inventory. Taxpayers were given an option to adopt the basis of either (*a*) cost or (*b*) cost or market, whichever is lower, for their 1920 inventories. The basis adopted for that year is controlling, and a change can now be made only after permission is secured from the Commissioner.

Application for permission to change the basis of valuing inventories shall be made at least 30 days prior to the close of the taxable year for which the change is to be effective. Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be the goods most recently purchased or produced, and the cost thereof will be the actual cost of the goods purchased or produced during the period in which the quantity of goods in the inventory has been acquired. Where the taxpayer maintains book inventories in accordance with a sound accounting system in which the respective inventory accounts are charged with the actual cost of the goods purchased or produced and credited with the value of goods used, transferred, or sold, calculated upon the basis of the actual cost of the goods acquired during the taxable year (including the inventory at the beginning of the year), the net value as shown by such inventory accounts will be deemed to be the cost of the goods on hand. The balances shown by such book inventories should be verified by physical inventories at reasonable intervals and adjusted to conform therewith.

Inventories should be recorded in a legible manner, properly computed and summarized, and should be preserved as a part of the accounting records of the taxpayer. The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted.

The following methods, among others, are sometimes used in taking or valuing inventories, but are not in accord with these regulations, viz:

(1) Deducting from the inventory a reserve for price changes, or an estimated depreciation in the value thereof.

(2) Taking work in process, or other parts of the inventory, at a nominal price or at less than its proper value.

(3) Omitting portions of the stock on hand.

(4) Using a constant price or nominal value for so-called normal quantity of materials or goods in stock.

(5) Including stock in transit, either shipped to or from the taxpayer, the title of which is not vested in the taxpayer.

ART. 103. **Inventories at cost.**—Cost means:

(1) In the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods.

(2) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which

may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

(3) In the case of merchandise produced by the taxpayer since the beginning of the taxable year, (*a*) the cost of raw materials and supplies entering into or consumed in connection with the product, (*b*) expenditures for direct labor, (*c*) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit.

(4) In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. Among such cases are (*a*) farmers and raisers of live stock (see article 106), (*b*) miners and manufacturers who by a single process or uniform series of processes derive a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike (see article 107), and (*c*) retail merchants who use what is known as the "retail method" in ascertaining approximate cost (see article 108).

ART. 104. **Inventories at market.**—Under ordinary circumstances and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases—

(*a*) Of goods purchased and on hand, and

(*b*) Of basic elements of cost (materials, labor, and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost.

Where no open market exists or where quotations are nominal, due to stagnant market conditions, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the

current price as above defined, the inventory may be valued at such prices less proper allowance for selling expense, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market.

ART. 105. **Inventories by dealers in securities.**—A dealer in securities, who in his books of account regularly inventories unsold securities on hand either—

(*a*) At cost;

(*b*) At cost or market, whichever is lower; or

(*c*) At market value,

may make his return upon the basis upon which his accounts are kept; provided that a description of the method employed shall be included in or attached to the return, that all the securities must be inventoried by the same method, and that such method must be adhered to in subsequent years, unless another be authorized by the Commissioner. For the purpose of this rule a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as here provided may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation and not in the course of an established business, and officers of corporations and members of partnerships who in their individual capacities buy and sell securities, are not dealers in securities within the meaning of this rule.

ART. 106. **Inventories of live stock raisers and other farmers.**—Farmers may change the basis of their returns from that of receipts and disbursements to that of an inventory basis provided adjustments are made in accordance with one of the two methods outlined in (1) and (2) below. It is optional with the taxpayer which method is used, but, having elected one method, the option so exercised will be binding upon the taxpayer, and he will be precluded from filing amended returns upon the basis of the other method.

(1) Opening and closing inventories shall be used for the year in which the change is made. There should be included in the opening inventory all farm products (including live stock) purchased or raised which were on hand at the date of the inventory, and there

must be submitted with the return for the current taxable year an adjustment sheet for the preceding taxable year based on the inventory method, upon the amount of which adjustment the tax shall be assessed and paid (if any be due) at the rate of tax in effect for that year. Ordinarily an adjustment sheet for the preceding year will be sufficient, but if, in the opinion of the Commissioner, such adjustment is not sufficient clearly to reflect income, adjustments for earlier years may be accepted or required. Where it is impossible to render complete inventories for the preceding year or years, the Commissioner will accept estimates which, in his opinion, substantially reflect the income on the inventory basis for such preceding year or years; but inventories must not include real estate, buildings, permanent improvements, or any other assets subject to depreciation.

(2) No adjustment sheets will be required, but the net income for the taxable year in which the change is made must be computed without deducting from the sum of the closing inventory and the sales and other receipts, the inventory of live stock, crops, and products at the beginning of the year; provided, however—

(*a*) That if any live stock, grain, or other property on hand at the beginning of the taxable year has been purchased and the cost thereof not charged to expense, only the difference between the cost and the selling price should be reported as income for the year in which sold;

(*b*) But if the cost of such property has been charged to expense for a previous year, the entire amount received must be reported as income for the year in which sold.

Because of the difficulty of ascertaining actual cost of live stock and other farm products, farmers who render their returns upon an inventory basis may at their option value their inventories for the current taxable year according to the "farm-price method," which provides for the valuation of inventories at market price less cost of marketing. If the use of the "farm-price method" of valuing inventories for any taxable year involves a change in method of valuing inventories from that employed in prior years, the opening inventory for the taxable year in which the change is made should be brought in at the same value as the closing inventory for the preceding taxable year. If such valuation of the opening inventory for the taxable year in which the change is made results in an abnormally large income for that year, there may be submitted with the return for such taxable year an adjustment statement for the preceding year based on the "farm-price method" of valuing inventories, upon the amount of which adjustments the tax, if any be

due, shall be assessed and paid at the rate of tax in effect for such preceding year. If an adjustment for the preceding year is not, in the opinion of the Commissioner, sufficient clearly to reflect income, adjustment sheets for prior years may be accepted or required.

Where returns have been made in which the taxable net income has been computed upon incomplete inventories, the abnormality should be corrected by submitting with the return for the current taxable year a statement for the preceding year in which such adjustments shall be made as are necessary to bring the closing inventory for the preceding year into agreement with the opening complete inventory for the current taxable year. If necessary clearly to reflect income, similar adjustments may be made as at the beginning of the preceding year or years, and the tax, if any be due, shall be assessed and paid at the rate of tax in effect for such year or years.

ART. 107. **Inventories of miners and manufacturers.**—A taxpayer engaged in mining or manufacturing who by a single process or uniform series of processes derives a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike, and who in conformity to a recognized trade practice allocates an amount of cost to each kind, size, or grade of product, which in the aggregate will absorb the total cost of production, may use such allocated cost as a basis for pricing inventories, provided such allocation bears a reasonable relation to the respective selling values of the different kinds of product.

ART. 108. **Inventories of retail merchants.**—Retail merchants who employ what is known as the "retail method" of pricing inventories may make their returns upon that basis, provided that the use of such method is designated upon the return, that accurate accounts are kept, and that such method is consistently adhered to unless a change is authorized by the Commissioner. Under this method the goods in the inventory are ordinarily priced at the selling prices, and the total retail value of the goods in each department or of each class of goods is reduced to approximate cost by deducting the percentage which represents the difference between the retail selling value and the purchase price. This percentage is determined by departments of a store or by classes of goods, and should represent as accurately as may be the amounts added to the cost prices of the goods to cover selling and other expenses of doing business and for the margin of profit. In computing the percentage above mentioned, proper adjustment should be made for all mark-ups and mark-downs.

A taxpayer maintaining more than one department in his store or dealing in classes of goods carrying different percentages of gross profit should not use a percentage of profit based upon an average

of his entire business, but should compute and use in valuing his inventory the proper percentages for the respective departments or classes of goods.

[SEC. 22. GROSS INCOME.]

(d) **Distributions by corporations.**—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

(e) **Determination of gain or loss.**—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in sections 111, 112, and 113.

(f) **Gross income from sources within and without United States.**—For computation of gross income from sources within and without the United States, see section 119.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) **Expenses.**—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

ART. 121. **Business expenses.**—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 141–271. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 55.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 122), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. As to items not deductible, see section 24 and articles 281–284.

ART. 122. **Traveling expenses.**—Traveling expenses as ordinarily understood, include railroad fares and meals and lodging. If the

trip is undertaken for other than business purposes, the railroad fares are personal expenses and the meals and lodging are living expenses. If the trip is solely on business, the reasonable and necessary traveling expenses, including railroad fares, meals, and lodging, become business instead of personal expenses.

(*a*) If, then, an individual, whose business requires him to travel, receives a salary as full compensation for his services, without reimbursement for traveling expenses, or is employed on a commission basis with no expense allowance, his traveling expenses, including the entire amount expended for meals and lodging, are deductible from gross income.

(*b*) If an individual receives a salary and is also repaid his actual traveling expenses, he shall include in gross income the amount so repaid and may deduct such expenses.

(*c*) If an individual receives a salary and also an allowance for meals and lodging, as, for example, a per diem allowance in lieu of subsistence, the amount of the allowance should be included in gross income and the cost of such meals and lodging may be deducted therefrom.

A payment for the use of a sample room at a hotel for the display of goods is a business expense. Only such expenses as are reasonable and necessary in the conduct of the business and directly attributable to it may be deducted. A taxpayer claiming the benefit of the deductions referred to herein must attach to his return a statement showing (1) the nature of the business in which engaged; (2) the number of days away from home during the taxable year on account of business; (3) the total amount of expenses incident to meals and lodging while absent from home on business during the taxable year; (4) the total amount of other expenses incident to travel and claimed as a deduction.

Claim for the deductions referred to herein must be substantiated, when required by the Commissioner, by evidence showing in detail the amount and nature of the expenses incurred.

Commuters' fares are not considered as business expenses and are not deductible.

ART. 123. **Cost of materials.**—Taxpayers carrying materials and supplies on hand should include in expenses the charges for materials and supplies only to the amount that they are actually consumed and used in operation during the year for which the return is made, provided that the cost of such materials and supplies has not been deducted in determining the net income for any previous year. If a taxpayer carries incidental materials or supplies on hand for which no record of consumption is kept or of which physical inventories

at the beginning and end of the year are not taken, it will be permissible for the taxpayer to include in his expenses and deduct from gross income the total cost of such supplies and materials as were purchased during the year for which the return is made, provided the net income is clearly reflected by this method.

ART. 124. **Repairs.**—The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as expense, provided the plant or property account is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, should be charged against the depreciation reserve if such account is kept. (See articles 201–210.)

ART. 125. **Professional expenses.**—A professional man may claim as deductions the cost of supplies used by him in the practice of his profession, expenses paid in the operation and repair of an automobile used in making professional calls, dues to professional societies and subscriptions to professional journals, the rent paid for office rooms, the cost of the fuel, light, water, telephone, etc., used in such offices, and the hire of office assistants. Amounts currently expended for books, furniture, and professional instruments and equipment, the useful life of which is short, may be deducted. As to items not deductible, see section 24 and articles 281–284.

ART. 126. **Compensation for personal services.**—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (*a*) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. (*b*) An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable in all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises in like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

ART. 127. **Treatment of excessive compensation.**—The income tax liability of the recipient in respect of an amount ostensibly paid to him as compensation, but not allowed to be deducted as such by the payor, will depend upon the circumstances of each case. Thus, in the case of excessive payments by corporations, if such payments correspond or bear a close relationship to stockholdings, and are found to be a distribution of earnings or profits, the excessive payments will be treated as a dividend, and will thus be exempt from the normal tax in the hands of the recipient. If such payments constitute payment for property, they should be treated by the payor as a capital expenditure and by the recipient as part of the purchase price.

ART. 128. **Bonuses to employees.**—Bonuses to employees will constitute allowable deductions from gross income when such payments are made in good faith and as additional compensation for the services actually rendered by the employees, provided such payments,

when added to the stipulated salaries, do not exceed a reasonable compensation for the services rendered. It is immaterial whether such bonuses are paid in cash or in kind or partly in cash and partly in kind. Donations made to employees and others, which do not have in them the element of compensation or are in excess of reasonable compensation for services, are not deductible from gross income.

ART. 129. **Pensions—Compensation for injuries.**—Amounts paid by a taxpayer for pensions to retired employees or to their families or others dependent upon them, or on account of injuries received by employees, and lump-sum amounts paid or accrued as compensation for injuries, are proper deductions as ordinary and necessary expenses. Such deductions are limited to the amount not compensated for by insurance or otherwise. When the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs, in recognition of the services rendered by the individual, such payments may be deducted. Salaries paid by employers to employees who are absent in the military, naval, or other service of the Government, but who intend to return at the conclusion of such service, are allowable deductions. As to deductions for payments to employees' pension trusts, see section 23 (q) and article 271.

ART. 130. **Rentals.**—Where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease, and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvements made, this deduction shall take the form of an allowance for depreciation. (See article 63.)

ART. 131. **Expenses of farmers.**—A farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in the carrying on of the business of farming. The cost of ordinary tools of short life or small cost, such as hand tools, including shovels, rakes, etc., may be deducted.

The cost of feeding and raising live stock may be treated as an expense deduction, in so far as such cost represents actual outlay, but not including the value of farm produce grown upon the farm or the labor of the taxpayer. Where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal, expenses deducted may be determined upon the crop basis, and such deductions must be taken in the year in which the gross income from the crop has been realized. The cost of farm machinery, equipment, and farm buildings represents a capital investment and is not an allowable deduction as an item of expense. Amounts expended in the development of farms, orchards, and ranches prior to the time when the productive state is reached may be regarded as investments of capital. Amounts expended in purchasing work, breeding, or dairy animals are regarded as investments of capital, and may be depreciated unless such animals are included in an inventory in accordance with article 57. The purchase price of an automobile, even when wholly used in carrying on farming operations, is not deductible, but is regarded as an investment of capital. The cost of gasoline, repairs, and upkeep of an automobile if used wholly in the business of farming is deductible as an expense; if used partly for business purposes and partly for the pleasure or convenience of the taxpayer or his family, such cost may be apportioned according to the extent of the use for purposes of business and pleasure or convenience, and only the proportion of such cost justly attributable to business purposes is deductible as a necessary expense. If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. (See also articles 57, 175, and 210.)

ART. 132. **Depositors' guaranty fund.**—Banking corporations which pursuant to the laws of the States in which they are doing business are required to set apart, keep, and maintain in their banks the amount levied and assessed against them by the State authorities as a "Depositors' guaranty fund," may deduct from their gross income the amount so set apart each year to this fund, provided that such fund, when set aside and carried to the credit of the State banking board or duly authorized State officer, ceases to be an asset of the bank and may be withdrawn in whole or in part upon demand by such board or State officer to meet the needs of these officers in reimbursing depositors in insolvent banks, and provided further

that no portion of the amount thus set aside and credited is returnable under the laws of the State to the assets of the banking corporation. If, however, such amount is simply set up on the books of the bank as a reserve to meet a contingent liability and remains an asset of the bank, it will not be deductible except as it is actually paid out as required by law and upon demand of the proper State officers.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME.]

[In computing net income there shall be allowed as deductions:]

(b) **Interest.**—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

ART. 141. **Interest.**—Interest paid or accrued within the year on indebtedness may be deducted from gross income, except that interest on indebtedness incurred or continued to purchase or carry securities, such as municipal bonds and first Liberty loan 3½ per cent bonds, the interest upon which is wholly exempt from tax, is not deductible. Since other obligations of the United States issued after September 24, 1917, are not wholly exempt from taxation under this title, interest paid on indebtedness incurred or continued to purchase such obligations (whether or not originally subscribed for by the taxpayer) is deductible in accordance with the general rule. Interest paid by the taxpayer on a mortgage upon real estate of which he is the legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness. Payments made for Maryland or Pennsylvania ground rents are not deductible as interest but may, under proper circumstances, be deducted as rent.

Interest calculated for cost-keeping or other purposes on account of capital or surplus invested in the business which does not represent a charge arising under an interest-bearing obligation, is not an allowable deduction from gross income. Interest paid by a corporation on scrip dividends is an allowable deduction. So-called interest on preferred stock, which is in reality a dividend thereon, can not be deducted in computing net income. (See articles 68 and 176 as to deduction of bond discount.) In the case of banks and loan or trust companies, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank or loan or trust company may be deducted from gross income.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME.]

[In computing net income there shall be allowed as deductions:]

(c) **Taxes generally.**—Taxes paid or accrued within the taxable year, except—

(1) income, war-profits, and excess-profits taxes imposed by the authority of the United States;

(2) so much of the income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit against the tax under section 131; and

(3) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

For the purpose of this subsection, estate, inheritance, legacy, and succession taxes accrue on the due date thereof, except as otherwise provided by the law of the jurisdiction imposing such taxes, and shall be allowed as a deduction only to the estate.

ART. 151. **Taxes.**—Federal taxes (except income, war-profits, and excess-profits taxes), State and local taxes (except taxes assessed against local benefits of a kind tending to increase the value of the property assessed), and taxes imposed by possessions of the United States or by foreign countries (except the amount of income, war-profits, and excess-profits taxes allowed as a credit against the tax), are deductible from gross income. See generally section 131 and articles 691–698 as to tax credits. Postage is not a tax. Amounts paid to States under secured debts laws in order to render securities tax exempt are deductible. Automobile license fees are ordinarily taxes. In general taxes are deductible only by the person upon whom they are imposed. As to tax paid at the source on interest from tax-free covenant bonds, see section 144 (a) (4) and article 761.

ART. 152. **Federal duties and excise taxes.**—Import or tariff duties paid to the proper customs officers, and business, license, privilege, excise, and stamp taxes paid to internal revenue collectors, are deductible as taxes imposed by the authority of the United States, provided they are not added to and made a part of the expenses of the business or the cost of articles of merchandise with respect to which they are paid, in which case they can not be separately deducted.

ART. 153. **Taxes for local benefits.**—So-called taxes, more properly assessments, paid for local benefits, such as street, sidewalk, and other like improvements, imposed because of and measured by some benefit inuring directly to the property against which the assessment is levied, do not constitute an allowable deduction from gross income.

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A tax is considered assessed against local benefits when the property subject to the tax is limited to property benefited. Special assessments are not deductible, even though an incidental benefit may inure to the public welfare. The taxes deductible are those levied for the general public welfare by the proper taxing authorities at a like rate against all property in the territory over which such authorities have jurisdiction. Assessments under the statutes of California relating to irrigation and of Iowa relating to drainage, and under certain statutes of Tennessee relating to levees, are limited to property benefited, and when it is clear that the assessments are so limited, the amounts paid thereunder are not deductible as taxes. The above statements are subject to the exception that in so far as assessments against local benefits are made for the purpose of maintenance or repair or for the purpose of meeting interest charges with respect to such benefits, they are deductible. In such cases the burden is on the taxpayer to show the allocation of the amounts assessed to the different purposes. If the allocation can not be made, none of the amounts so paid is deductible.

ART. 154. **Federal estate and State inheritance taxes.**—Federal estate taxes, paid or accrued during the taxable year, are an allowable deduction from the gross income of the estate in computing the net income thereof subject to tax. The whole amount of such taxes, irrespective of when paid, is deemed to have accrued on the due date thereof, namely, one year after the decedent's death (see section 305 of the Revenue Act of 1926), and, if the accounts of the estate are kept on an accrual basis, is deductible from gross income of the taxable year in which such due date falls. If the accounts are kept on the basis of cash receipts and disbursements, deduction may be taken from gross income of the taxable year or years in which the payment or payments may have been made.

Estate, succession, legacy, or inheritance taxes, imposed by any State, Territory, or possession of the United States, or foreign country, are deductible by the estate, whether by the laws of the jurisdiction exacting them, they are imposed upon the right or privilege to transmit or upon the right or privilege of the heir, devisee, legatee, or distributee to receive or to succeed to the property of the decedent passing to him.

The accrual dates of such taxes shall be the due date thereof except as otherwise provided by the law of the jurisdiction imposing them. Where deduction is claimed of any such taxes, the amount thereof and the name of the State, Territory, or possession of the United

States, or foreign country by which they have been imposed shall be stated in the return.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME.]

[In computing net income there shall be allowed as deductions:]

(d) Taxes of shareholder paid by corporation.—The deduction for taxes allowed by subsection (c) shall be allowed to a corporation in the case of taxes imposed upon a shareholder of the corporation upon his interest as shareholder which are paid by the corporation without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.

ART. 161. **Tax on bank or other stock.**—Banks or other corporations paying taxes assessed against their shareholders on account of their ownership of the shares of stock issued by such corporations without reimbursement from such shareholders may deduct the amount of taxes so paid. The Act specifically provides, however, that in such cases the shareholders may not deduct the amount of the taxes. The amount so paid should not be included in the income of the shareholder.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME.]

[In computing net income there shall be allowed as deductions:]

(e) Losses by individuals.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft.

(f) Losses by corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

(g) Basis for determining loss.—The basis for determining the amount of deduction for losses sustained, to be allowed under subsection (e) or (f), shall be the same as is provided in section 113 for determining the gain or loss from the sale or other disposition of property.

(h) Loss on sale of stock or securities.—For disallowance of loss deduction in the case of sales of stock or securities where within thirty days before or after the date of the sale the taxpayer has acquired substantially identical property, see section 118.

(i) Net losses.—The special deduction for net losses of prior years, to the extent provided in section 117.

ART. 171. **Losses.**—Losses sustained by individuals during the taxable year and not compensated for by insurance or otherwise are fully deductible (except by nonresident aliens, see section 213 and article 1051) if—

(*a*) Incurred in a taxpayer's trade or business, or

(*b*) Incurred in any transaction entered into for profit, or

(*c*) Arising from fires, storms, shipwreck, or other casualty, or theft.

Losses sustained by corporations during the taxable year and not compensated for by insurance or otherwise are deductible.

Losses must usually be evidenced by closed and completed transactions. The basis for determining the amount of the deduction for losses is the same as is provided in section 113 for determining the gain or loss from the sale or other disposition of property. (See articles 591–604.) Proper adjustment must be made in each case for any expenditure, receipt, loss, or other item properly chargeable to capital account, and for depreciation, obsolescence, amortization, or depletion. (See section 111 and article 561.) Moreover, the amount of the loss must be reduced by the amount of any insurance or other compensation received, and by the salvage value, if any, of the property. A loss occasioned by damage to an automobile maintained for pleasure, where such damage results from the faulty driving of the taxpayer or other person operating the automobile, but is not due to the willful act or willful negligence of the taxpayer, is a deductible loss in the computation of net income. Where damage to a taxpayer's automobile results from the faulty driving of the operator of an automobile with which the automobile of the taxpayer collides, the loss occasioned to the taxpayer by such damage is likewise deductible. No loss is realized by the transfer of property by gift or by death. But see section 44 (d) and article 355.

A loss on the sale of residential property purchased or constructed by the taxpayer for use as his personal residence and so used by him up to the time of the sale is not deductible. Where, however, property so purchased or constructed is prior to its sale rented or otherwise appropriated to income-producing purposes and is used for such purposes up to the time of its sale, a loss from the sale of the property, computed as provided in section 111 and article 561, is an allowable deduction in an amount not to exceed the excess of the value of the property at the time it was appropriated to income-producing purposes (with proper adjustment for depreciation) over the amount realized from the sale. However, in case the property was so appropriated prior to March 1, 1913, the loss is an allowable deduction in an amount not to exceed the excess of the value of the property

at the time it was so appropriated or at March 1, 1913, whichever is greater (with proper adjustment for depreciation), over the amount realized from the sale.

Example: Residential property was purchased by a taxpayer in 1920 for use as his personal residence at a cost of $25,000, of which $15,000 was allocable to the building. The property was so used by the taxpayer until January 1, 1925. From that date to January 1, 1928, when the property was sold, it was rented by the taxpayer. The fair market value of the property at the time it was rented on January 1, 1925, was $22,000. The building had an estimated life of 20 years when the property was purchased by the taxpayer in 1920. The property was sold on January 1, 1928, for $16,000. The loss from the sale allowable as a deduction is $3,750, computed as follows:

Cost of property in 1920	$25,000
Less depreciation allowable in respect of the building (depreciation for 3 years at 5 per cent based on $15,000, cost of building)	2,250
	22,750
Selling price of property	16,000
Loss computed as provided in section 111 and article 561	6,750
Value of property at time it was rented on January 1, 1925	22,000
Less proper adjustment for depreciation	2,250
	19,750
Selling price of property	16,000
Portion of $6,750 loss which is deductible	3,750

See section 101 and articles 501–503 as to capital losses. See section 117 and articles 651–655 as to deduction for net losses of prior years. See section 118 and article 661 as to disallowance of loss deduction in the case of sales of stock or securities where within 30 days before or after the date of the sale the taxpayer has acquired substantially identical property.

ART. 172. **Voluntary removal of buildings.**—Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income. When a taxpayer buys real estate upon which is located a building, which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the pur-

chase price of the land and building plus the cost of removing the useless building.

ART. 173. **Loss of useful value.**—When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis (adjusted as provided in section 111 and article 561) and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income.

ART. 174. **Shrinkage in value of stocks.**—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis determined under section 113 may be deducted by the owner in the taxable year in which the stock became worthless, provided a satisfactory showing of its worthlessness be made, as in the case of bad debts. Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders or general policy of such supervisory officers charge off stock as worthless or write it down to a nominal value, such stock shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed for income tax purposes to be worthless. For dealers in securities, see article 105.

ART. 175. **Losses of farmers.**—Losses incurred in the operation of farms as business enterprises are deductible from gross income. If farm products are held for favorable markets, no deduction on account of shrinkage in weight or physical value or by reason of deterioration in storage shall be allowed, except as such shrinkage may be reflected in an inventory if used to determine profits. The total loss by frost, storm, flood, or fire of a prospective crop is not a deductible loss in computing net income. A farmer engaged in raising and selling stock, cattle, sheep, horses, etc., is not entitled to claim as a loss the value of animals that perish from among those animals that were raised on the farm, except as such loss is reflected in an inventory if used. If live stock has been purchased after February 28, 1913, for any purpose, and afterwards dies from disease, exposure, or injury, or is killed by order of the authorities of a State or the United States, the actual purchase price of such stock, less any depreciation allowable as a deduction in respect of such perished live stock, may be deducted as a loss if the loss is not compensated for by insurance or otherwise. The actual cost of other property (with proper adjustment for depreciation) which is destroyed by order of the authorities of a State or of the United States, may in like manner be claimed as a loss. If reimbursement is made by a State or the United States in whole or in part on account of stock killed or other property destroyed in respect of which a loss was claimed for a prior year, the amount received shall be reported as income for the year in which reimbursement is made. The cost of any feed, pasturage, or care which has been deducted as an expense of operation shall not be included as part of the cost of the stock for the purpose of ascertaining the amount of a deductible loss. If gross income is ascertained by inventories, no deduction can be made for live stock or products lost during the year, whether purchased for resale or produced on the farm, as such losses will be reflected in the inventory by reducing the amount of live stock or products on hand at the close of the year. If an individual owns and operates a farm, in addition to being engaged in another trade, business, or calling, and sustains a loss from such operation of the farm, then the amount of loss sustained may be deducted from gross income received from all sources, provided the farm is not operated for recreation or pleasure. (See articles 57, 131, and 210.)

ART. 176. **Sale of capital stock, bonds, and capital assets.**—A corporation sustains no deductible loss from the sale of its capital stock. (See article 66.) If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess

may usually be deducted as expense. (See article 68.) Any loss sustained by a corporation upon the sale of its capital assets, computed as provided in sections 111–113 and articles 561–604, subject to the limitation provided in section 118 as to the purchase and sale of stock or securities, is deductible.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME.]

[In computing net income there shall be allowed as deductions:]

(j) **Bad debts.**—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part.

ART. 191. **Bad debts.**—Bad debts may be treated in either of two ways—

(1) By a deduction from income in respect of debts ascertained to be worthless in whole or in part, or

(2) By a deduction from income of an addition to a reserve for bad debts.

Taxpayers were given an option for 1921 to select either of the methods mentioned for treating such debts. (See article 151, Regulations 62.) The method used in the return for 1921 must be used in returns for subsequent years and in returns under the Revenue Act of 1928 unless permission is granted by the Commissioner to change to the other method. A taxpayer filing a first return of income may select either of the two methods subject to approval by the Commissioner upon examination of the return. If the method selected is approved, it must be followed in returns for subsequent years, except as permission may be granted by the Commissioner to change to another method. Application for permission to change the method of treating bad debts shall be made at least 30 days prior to the close of the taxable year for which the change is to be effective. (See also article 195.)

Where all the surrounding and attending circumstances indicate that a debt is worthless, either wholly or in part, the amount which is worthless and charged off or written down to a nominal amount on the books of the taxpayer shall be allowed as a deduction in computing net income. There should accompany the return a statement showing the propriety of any deduction claimed for bad debts. No deduction shall be allowed for the part of a debt ascertained to be worthless and charged off prior to January 1, 1921, unless and until the debt is ascertained to be totally worthless and is finally charged off or is written down to a nominal amount, or the loss is determined in some other manner by a closed and completed transaction. Before a taxpayer may charge off and deduct a debt in part, he must ascertain and be able to demonstrate, with a reasonable degree of certainty, the amount thereof which is uncollectible. Any amount subsequently received on account of a bad debt or on account of a part of such debt previously charged off and allowed as a deduction for income tax purposes, must be included in gross income for the taxable year in which received. In determining whether a debt is worthless in whole or in part the Commissioner will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor. Partial deductions will be allowed with respect to specific debts only.

Where the surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of the worthlessness of the debt for the purpose of deduction. Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt. Actual determination of worthlessness in bankruptcy cases is sometimes possible before and at other times only when a settlement in bankruptcy shall have been had. Where a taxpayer ascertained a debt to be worthless and charged it off in one year, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, confirming the conclusion that the debt is worthless, will not authorize shifting the deduction to such later year. If a taxpayer computes his income upon the basis of valuing his notes or accounts receivable at their fair market value when received, which may be less than their face value, the amount deductible for bad debts in any case is limited to such original valuation.

Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders, or in accordance with the general policy of such supervisory officers, charge off debts in whole or in part, such debts shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be.

ART. 192. **Examples of bad debts.**—Worthless debts arising from unpaid wages, salaries, rents, and similar items of taxable income will not be allowed as a deduction unless the income such items represent has been included in the return of income for the year in which the deduction as a bad debt is sought to be made or in a previous year. Only the difference between the amount received in distribu-

tion of the assets of a bankrupt and the amount of the claim may be deducted as a bad debt. The difference between the amount received by a creditor of a decedent in distribution of the assets of the decedent's estate and the amount of his claim may be considered a worthless debt. A purchaser of accounts receivable which can not be collected and are consequently charged off the books as bad debts is entitled to deduct them, the amount of deduction to be based upon the price he paid for them and not upon their face value.

ART. 193. **Uncollectible deficiency upon sale of mortgaged or pledged property.**—Where mortgaged or pledged property is lawfully sold (whether to the creditor or another purchaser) for less than the amount of the debt, and the mortgagee or pledgee ascertains that the portion of the indebtedness remaining unsatisfied after such sale is wholly or partially uncollectible, and charges it off, he may deduct such amount (to the extent that it constitutes capital or represents an item the income from which has been returned by him) as a bad debt for the taxable year in which it is ascertained to be wholly or partially worthless and charged off. In addition, where the creditor buys in the mortgaged or pledged property, loss or gain is realized measured by the difference between the amount of those obligations of the debtor which are applied to the purchase or bid price of the property (to the extent that such obligations constitute capital or represent an item the income from which has been returned by him) and the fair market value of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

Accrued interest may be included as part of the deduction only when it has previously been returned as income.

ART. 194. **Worthless securities.**—Where bonds purchased before March 1, 1913, depreciated in value between the date of purchase and that date, and were in a later year ascertained to be worthless and charged off, the owner is entitled to a deduction in that year equal to the cost of the bonds. Bonds purchased since February 28, 1913, when ascertained to be worthless, may be treated as bad debts to the amount actually paid for them. Bonds of an insolvent corporation secured only by a mortgage from which on foreclosure nothing is realized for the bondholders are regarded as ascertained to be worthless not later than the year of the foreclosure sale, and no deduction for a bad debt is allowable in computing a bondholder's income for a subsequent year. A deduction for a bad debt based

upon the value of the debt on March 1, 1913, is allowable only when such value is established to the satisfaction of the Commissioner.

A taxpayer (other than a dealer in securities) possessing debts evidenced by bonds or other similar obligations can not deduct from gross income any amount merely on account of market fluctuation. Where a taxpayer ascertains, however, that due, for instance, to the financial condition of the debtor, or conditions other than market fluctuation, he will recover upon maturity none or only a part of the debt evidenced by the bonds or other similar obligations and so demonstrates to the satisfaction of the Commissioner, he may deduct in computing net income the uncollectible part of the debt evidenced by the bonds or other similar obligations.

ART. 195. **Reserve for bad debts.**—Taxpayers who have, prior to 1928, established the reserve method of treating bad debts and maintained proper reserve accounts for bad debts, or who, in accordance with article 191, or upon securing permission from the Commissioner, adopt the reserve method of treating bad debts, may deduct from gross income a reasonable addition to a reserve for bad debts in lieu of a deduction for specific bad debt items.

What constitutes a reasonable addition to a reserve for bad debts must be determined in the light of the facts, and will vary as between classes of business and with conditions of business prosperity. A taxpayer using the reserve method should make a statement in his return showing the volume of his charge sales (or other business transactions) for the year and the percentage of the reserve to such amount, the total amount of notes and accounts receivable at the beginning and close of the taxable year, and the amount of the debts which have been ascertained to be wholly or partially worthless and charged against the reserve account during the taxable year.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME.]

[In computing net income there shall be allowed as deductions:]

(k) Depreciation.—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

ART. 201. **Depreciation.**—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such

an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the basis of the property determined in accordance with section 113 and articles 591–604. Due regard must also be given to expenditures for current upkeep. In the case of property held by one person for life with remainder to another person, the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, will be allowed to the remainderman. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee.

ART. 202. **Depreciable property.**—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, nor to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provisions for this

being made in the Act. (See sections 23(l) and 114 and articles 221–257 and 611.) Property kept in repair may, nevertheless, be the subject of a depreciation allowance. (See article 124.) The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure, a building used by the taxpayer solely as his residence, nor in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

ART. 203. **Depreciation of intangible property.**—Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses, and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner. No deduction for depreciation, including obsolescence, is allowable in respect of good will.

ART. 204. **Capital sum recoverable through depreciation allowances.**—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. (See sections 113 and 114 and articles 591–604 and 611.) To this amount should be added from time to time the cost of improvements, additions, and betterments, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump price, as, for example, buildings and land, the capital sum to be replaced is limited to an amount which bears the same proportion to the lump price as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time. Where the lessee of real property erects buildings, or makes permanent improvements which become part of the realty and income has been returned by the lessor as a result thereof, as provided in article 63, the capital sum to be replaced by depreciation allow-

ances is held to be the same as though no such buildings had been erected or such improvements made. In the case of property which has been the subject of deductions for amortization under sections 214 (a) (9) and 234 (a) (8) of the Revenue Acts of 1918 and 1921, depreciation deductions will be computed after the close of the amortization period upon the cost or other basis of such property after the amortization allowance has been deducted. No depreciation deduction will be allowed in the case of property which has been amortized to its scrap value and is no longer in use. (See article 182 of Regulations 45 and 62.)

ART. 205. **Method of computing depreciation allowance.**—The capital sum to be replaced should be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. While the burden of proof must rest upon the taxpayer to sustain the deduction taken by him, such deductions will not be disallowed unless shown by clear and convincing evidence to be unreasonable. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If it develops that the useful life of the property will be longer or shorter than the useful life as originally estimated under all the then known facts, the portion of the cost or other basis of the property not already provided for through depreciation allowable determined in accordance with the useful life of the property as originally estimated, should be spread over the remaining useful life of the property as reestimated in the light of the subsequent facts, and depreciation deductions taken accordingly. Where the cost of the property or its fair market value as of March 1, 1913, has been recovered through depreciation allowances, no further deduction for depreciation shall be allowed.

ART. 206. **Obsolescence.**—With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions that will result in its being abandoned at a future date prior to the end of its normal useful life, so that depreciation deductions alone are insufficient to return the cost (or other basis) at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. No deduction for obsolescence will be permitted merely

because, in the opinion of a taxpayer, the property may become obsolete at some later date. This allowance will be confined to such portion of the property on which obsolescence is definitely shown to be sustained and can not be held applicable to an entire property unless all portions thereof are affected by the conditions to which obsolescence is found to be due.

ART. 207. **Depreciation of patent or copyright.**—In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost or other basis of the patent or copyright. The allowance should be computed by an apportionment of the cost or other basis of the patent or copyright over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or since March 1, 1913, as the case may be. If the patent or copyright was acquired from the Government, its cost consists of the various Government fees, cost of drawings, experimental models, attorneys' fees, development or experimental expenses, etc., actually paid. Depreciation of a patent can be taken on the basis of the fair market value as of March 1, 1913, only when affirmative and satisfactory evidence of such value is offered. Such evidence should whenever practicable be submitted with the return. If the patent becomes obsolete prior to its expiration, such proportion of the amount on which its depreciation may be based as the number of years of its remaining life bears to the whole number of years intervening between the basic date and the date when it legally expires may be deducted, if permission so to do is specifically secured from the Commissioner. Owing to the difficulty of allocating to a particular year the obsolescence of a patent, such permission will be granted only if affirmative and satisfactory evidence that the patent became obsolete in the year for which the return is made is submitted to the Commissioner. The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable.

ART. 208. **Depreciation of drawings and models.**—Where a taxpayer has incurred expenditures in his business for designs, drawings, patterns, models, or work of an experimental nature calculated to result in improvement of his facilities or his product, if the period of usefulness of any such asset may be estimated from experience with reasonable accuracy, it may be the subject of depreciation allowances spread over such estimated period of usefulness. The facts must be fully shown in the return or prior thereto to the satisfaction of the Commissioner. Except for such depreciation allowances no deduction shall be made by the taxpayer against any sum so set up as

an asset except on the sale or other disposition of such asset at a loss or on proof of a total loss thereof.

ART. 209. **Records of depreciable property.**—In order that the verification of depreciation allowances claimed by the taxpayer may be facilitated, depreciation should be recorded on the taxpayer's books, the amount measuring a reasonable allowance for depreciation either being deducted directly from the book value of the assets or preferably being credited to a depreciation reserve account, which should be reflected in the annual balance sheet. For the same reason the allowances should be computed and recorded with express reference to specific items, units, or groups of property, each item or unit being considered separately or specifically included in a group with others to which the same factors apply. Also, the taxpayer's books should show the basis of the depreciable property and any adjustments thereto, and, in cases where the basis of the property is other than cost, or value on March 1, 1913, or value at date of acquisition (as, for example, if the property was acquired by gift or transfer in trust after December 31, 1920, or through a reorganization or a tax-free exchange (see particularly section 113 (a) and articles 591–604)), the books should show the data used in ascertaining such basis and the adjustments thereto.

ART. 210. **Depreciation in the case of farmers.**—A reasonable allowance for depreciation may be claimed on farm buildings (other than a dwelling occupied by the owner), farm machinery, and other physical property. A reasonable allowance for depreciation may also be claimed on live stock acquired for work, breeding, or dairy purposes, unless they are included in an inventory used to determine profits in accordance with article 57. Such depreciation should be based on the cost or other basis and the estimated life of the live stock. If such live stock be included in an inventory no depreciation thereof will be allowed, as the corresponding reduction in their value will be reflected in the inventory. (See also articles 131 and 175.)

[SEC. 23. DEDUCTIONS FROM GROSS INCOME.]

[In computing net income there shall be allowed as deductions:]

(l) **Depletion.**—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the case of leases the deduction shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. (For percentage depletion in case of oil and gas wells, see section 114 (b) (3).)

(m) **Basis for depreciation and depletion.**—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

ART. 221. **Depletion of mines, oil and gas wells; depreciation of improvements.**—Section 23 (l) provides that taxpayers shall be allowed as a deduction in computing net income in the case of natural deposits a reasonable allowance for depletion of mineral and for depreciation of improvements. See section 114 and articles 241 and 611 with reference to the basis for computing depreciation and depletion.

The essence of these provisions of the Act is that the owner of mineral deposits, whether freehold or leasehold, shall, within the limitations prescribed, secure through an aggregate of annual depletion and depreciation deductions the return of either the cost of his property or the value of his property on the basic date plus, in either case, subsequent allowable capital additions (see articles 242 and 243), but not including land values for purposes other than the extraction of minerals. But see section 114 (b) (3) and article 241.

Operating owners, lessors, and lessees, whether corporations or individuals, are entitled to deduct an allowance for depletion and depreciation, but a shareholder in a mining or oil or gas corporation is not allowed such deductions with respect to the property of the corporation. But see article 626.

The principles governing the apportionment of depreciation in the case of property held by one person for life with remainder to another person and in the case of property held in trust are also applicable to depletion. (See article 201.)

When used in these articles (221–257) covering depletion and depreciation—

(*a*) The term "basic date" means the date as of which property is valued for the purpose of determining its basis for depletion, such as the date of discovery or within 30 days thereafter, in the case of the discovery of a mine. In cases in which the basis for depletion of property under sections 113 and 114 is neither the cost nor the value of the property on any basic date (for example, cases in which "the basis shall be the same as it would be in the hands of the transferor"), the term "value of the property on the basic date" and any

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equivalent term are to be taken to mean the basis prescribed in section 113.

(*b*) The "fair market value" of a property is that amount which would induce a willing seller to sell and a willing buyer to purchase.

(*c*) A "mineral property" is the mineral deposit, the development and plant necessary for its extraction, and so much of the surface only as is reasonably expected to be underlaid with the mineral. The value of a mineral property is the combined value of its component parts.

(*d*) A "mineral deposit" refers to minerals only, such as the ores only in the case of a mine, to the oil only in the case of an oil well, and to the gas only in the case of a gas well, and to the oil and gas in the case of a well producing both oil and gas. The value of a mineral deposit is the value of the mineral property, less the value of the plant and equipment, and less the value of the surface of the land for purposes other than mineral production. The cost of a mineral deposit is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

(*e*) "Minerals" include ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, barytes, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, sulphur, and talc.

(*f*) "Operating profit" is the net amount received from the sale of minerals before depletion and depreciation are deducted. It is distinct from net income, as defined in section 21.

(*g*) "Depletion or depreciation sustained" means (except in cases where a discovery value has been established, as to which see paragraph (*h*)) depletion or depreciation actually sustained, whether legally allowable or not, based on the cost or value as at the basic date, as the case may be.

(*h*) "Depletion allowance in case of discovery": The deduction for depletion in case of the discovery of a mine shall not exceed 50 per cent of the net income, computed without allowance for depletion, from the property upon which the discovery is made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value. The phrase "net income of the taxpayer (computed without allowance for depletion)" means the gross income from the sale of all mineral products from the discovery ore body less the deductions in respect to the property

upon which the discovery is made, including overhead and operating expenses, depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. If the mineral products are not sold as raw material but are manufactured or converted into a refined product, then the gross income shall be assumed to be equivalent to the market or field price of the raw material before conversion. Depreciation, taxes, and such expenses as overhead (which can not be directly attributed to the discovery ore body) shall be allocated on the basis of the ratio of the number of units produced from such discovery ore body to the total number of units produced from the particular operating division in which the discovery ore body is located.

(*i*) "Depletion allowance based on the income from oil and gas wells": The deduction for depletion based on the income from oil and gas wells shall not exceed 50 per cent of the net income of the taxpayer, computed without allowance for depletion, from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to the income from the property. The phrase "net income of the taxpayer (computed without allowance for depletion)" means the gross income from the sale of oil and gas less the deductions in respect to the property upon which depletion is claimed, including overhead and operating expenses, development expenses (if the taxpayer has elected to deduct development expenses), depreciation, taxes, losses sustained, etc., but excluding any allowance for depletion. If the oil and gas are not sold on the property but are manufactured or converted into a refined product or are transported from the property prior to sale, then the gross income shall be assumed to be equivalent to the market or field price of the oil and gas before conversion or transportation. Depreciation, taxes, and such expenses as overhead (which can not be directly attributed to any particular property) shall be allocated on the basis of the ratio of the number of units produced from the property on which depletion is claimed to the total number of units produced from the operating division in which the property is located. In cases where the taxpayer, in addition to producing oil and gas, engages in additional activities such as operating refineries and transportation lines, depreciation, taxes, and such expenses as overhead which can not be directly attributed to any specific activity, shall be allocated to the production of oil and gas on the basis of the ratio which the operating expenses and development expenses (if the taxpayer has elected to deduct development expenses) directly attributable to the production of oil and gas bear to the taxpayer's total operating expenses and development expenses.

ART. 222. **Amount returnable through depletion and depreciation deductions in the case of an operating owner.**—In the case of an operating owner in fee, the amount remaining in any year returnable through depletion and depreciation deductions is (*a*) the cost or value of the property at the basic date plus (*b*) subsequent allowable capital additions and minus (*c*) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year and minus (*d*) the cost or value of the land at the basic date for other purposes than mineral production and the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation. The provisions of this paragraph do not apply to the computation of the depletion allowance in the case of oil and gas wells when such allowance is based on the income from the property.

ART. 223. **Amount returnable through depletion and depreciation deductions in the case of lessee.**—(*a*) In the case of a lessee, the amount remaining in any year returnable through depletion and depreciation deductions is (1) the value as of the basic date of the lessee's equity in the property plus (2) subsequent allowable capital additions and minus (3) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year and minus (4) the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation. The provisions of this paragraph do not apply to the computation of the depletion allowance in the case of oil and gas wells when such allowance is based on the income from the property.

(*b*) The values of the equities of lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

(*c*) The value of a lessee's equity, if acquired prior to March 1, 1913, is to be taken to mean (1) its cost or (2) the value of his interest in the mineral as of that date, whichever is greater.

(*d*) The value of a lessee's equity in a proven mineral property acquired on or after March 1, 1913, is to be taken to mean its cost.

(*e*) The value of a lessee's equity in a discovery after February 28, 1913, is the fair market value at date of discovery, or within 30 days thereafter, of his equity in the mineral discovered.

ART. 224. **Amount returnable through depletion and depreciation deductions in the case of lessor.**—(*a*) In the case of a lessor, the amount remaining in any year returnable through depletion and depreciation

deductions is (1) the value of his equity in the property at the basic date minus (2) depletion and depreciation sustained, whether legally allowable or not, from the basic date to the taxable year plus (3) subsequent allowable capital additions and minus (4) the value of the land at the basic date for other purposes than mineral production and the residual value of other property at the end of operations. The amount returnable through depletion is the total capital remaining less the sum recoverable through depreciation. The provisions of this paragraph do not apply to the computation of the depletion allowance in the case of oil and gas wells when such allowance is based on the income from the property.

(*b*) The values of the equities of lessor and lessee shall be computed separately, but, when determined as of the same basic date, shall together never exceed the value at that date of the property in fee simple.

(*c*) The value of the lessor's equity in the case of a mineral property not under lease on March 1, 1913, but subsequently leased, is to be taken to mean (1) the cost or (2) the en bloc value of the mineral in the ground on March 1, 1913, whichever is greater, and will, in the absence of satisfactory evidence to the contrary, be presumed not to exceed the value as of March 1, 1913, of the royalties to be expected under the lease.

(*d*) The value of a lessor's equity in a mineral property under lease March 1, 1913, for the entire operating life of the mineral deposits is to be taken to mean (1) the cost or (2) the value as of March 1, 1913, of the royalties and other payments to be expected under the terms of the lease in effect on that date, whichever is greater.

(*e*) The value of a lessor's equity in a mineral property under lease March 1, 1913, for a portion of its operating life is to be taken to mean (1) the cost or (2) the value as of March 1, 1913, of the royalties expected from the mineral to be extracted during the life of the existing lease plus the estimated en bloc value of the mineral remaining at its expiration, which, in the absence of satisfactory evidence to the contrary, will be presumed not to exceed the value as of March 1, 1913, of royalties which could have been expected as at that date from the remaining mineral.

(*f*) The value of a lessor's equity in a mineral property when acquired on or after March 1, 1913, is to be taken to mean its cost.

(*g*) The value of a lessor's equity in a discovery after February 28, 1913, is the fair market value at the date of discovery, or within 30 days thereafter, of his equity in the mineral discovered.

ART. 225. **Determination of cost of deposits.**—In any case in which a depletion or depreciation deduction is computed on the basis of the cost or price at which any mine, mineral deposit, mineral right, or leasehold was acquired, the owner or lessee will be required to show that the cost or price at which the property was bought was fixed for the purpose of a bona fide purchase and sale, by which the property passed in fact as well as in form to an owner other than the vendor. No fictitious or inflated cost or price will be permitted to form the basis of any calculation of a depletion or depreciation deduction, and in determining whether or not the price or cost at which any purchase or sale was made represented the actual market value of the property sold, due weight will be given to the relationship or connection existing between the person selling the property and the buyer thereof.

ART. 226. **Determination of fair market value of mineral properties other than oil and gas properties.**—(*a*) Where the fair market value of the property at a specified date is the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Commissioner, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the mineral product. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. The Commissioner will give due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties and rentals, value fixed by the owner for purpose of the capital stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, and, in the absence of better evidence, disinterested appraisals by approved methods. Valuations by analytic appraisal methods, such as the present value method, are not entitled to great weight, (1) if the value of a mineral deposit can be determined upon the basis of cost or replacement value, (2) if the knowledge of the presence of the mineral has not greatly enhanced the value of the mineral property, (3) if the removal of the mineral does not materially reduce the value of the property from which it is taken, or (4) if the profits arising from the exploitation of the mineral deposit are wholly or in great part due to the manufacturing or marketing ability of the taxpayer or to extrinsic causes other than the possession

of the mineral itself. Where the fair market value must be ascertained as of a certain date, analytic appraisal methods will not be used if the fair market value can reasonably be determined by any other method.

(*b*) To determine the fair market value of a mineral property by the present value method, the essential factors must be determined for each deposit included in the property. The essential factors are (1) the total operating profit, (2) the rate at which this profit will be obtained, and (3) the rate of interest commensurate with the risk for the particular deposit. In order to estimate the total operating profit it is necessary to determine the quantity, quality, and recoverable mineral content of the developed, probable, and prospective ore reserves in all cases. For mines with a prior operating record the "spread of profit" per unit of recoverable mineral, or the percentage of net profit to gross proceeds from mineral production is the other factor required in estimates of the total expected profit. For mines with no prior operating record the future sales price and future production cost per unit of mineral must be estimated in order to determine the "spread of profit" per unit of recoverable mineral. In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality or grade of the mineral, percentage of recovery, cost of development, production, and selling price of the product marketed during the expected operating life of the mineral deposit.

(*c*) Mineral deposits for which these factors may not be determined with reasonable accuracy from past operating experience may, with the approval of the Commissioner, be valued in a similar manner; but the factors must be deduced from concurrent evidence, such as the general type of the deposit, the characteristics of the district in which it occurs, the habit of the mineral deposits in the property itself, the intensity of mineralization, the rate at which additional mineral has been disclosed by exploitation, the stage of the operating life of the property, and any other evidence tending to establish a reasonable estimate of the required factors.

(*d*) Mineral deposits of different grades, locations, and probable dates of extraction in a mineral property should be valued separately. The mineral content of a deposit shall be determined in accordance with article 229. In estimating the average grade of the developed and prospective mineral, account should be taken of probable increases or decreases as indicated by the operating history. The rate of exhaustion of a mineral deposit should be determined with due regard to the limitations imposed by plant capacity, by the

character of the deposit, by the ability to market the mineral product, by labor conditions, and by the operating program in force or reasonably to be expected at the basic date for future operations. The operating life of a mineral deposit is that number of years necessary for the exhaustion of both the developed and prospective mineral content at the rate determined as above. The operating cost includes all current expense of producing, preparing, and marketing the mineral product sold (due consideration being given to taxes) exclusive of allowable capital additions as defined in article 242 and deductions for depreciation and depletion, but including cost of repairs. This cost of repairs is not to be confused with the depreciation deduction by which the cost or value of plant and equipment is returned to the taxpayer free from tax. In general, no estimates of these factors will be approved by the Commissioner which are not supported by the operating experience of the property or which are derived from different and arbitrarily selected periods.

(*e*) The number of units of mineral recoverable in marketable form multiplied by the estimated operating profit per unit gives the total expected operating profit. The value of each mineral deposit is then the total expected operating profit from that deposit reduced to a present value as of the basic date at the rate of interest commensurate with the risk for the operating life, and further reduced by the value at the basic date of the depreciable assets and of the capital additions, if any, necessary to realize the profits. The degree of risk is generally lowest in cases where the factors of valuation are fully supported by the operating record of the mineral property prior to the basic date; relatively higher risks attach to appraisals upon any other basis.

ART. 227. **Determination of fair market value of oil and gas properties.**—(*a*) Where the fair market value of the property at a specified date is the basis for depletion and depreciation deductions, such value must be determined, subject to approval or revision by the Commissioner, by the owner of the property in the light of the conditions and circumstances known at that date, regardless of later discoveries or developments in the property or subsequent improvements in methods of extraction and treatment of the oil and gas product. The value sought should be that established assuming a transfer between a willing seller and a willing buyer as of that particular date. The Commissioner will give due weight and consideration to any and all factors and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, market value of stock or shares, royalties and rentals, value fixed by the owner for purpose of the capital stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property was in question, the amount at which the property may have been inventoried in probate court, and, in the absence of better evidence, disinterested appraisals by approved methods. Where the fair market value must be ascertained as of a certain date, analytic appraisal methods, such as the present value method, will not be used if the fair market value can reasonably be determined by any other method.

(*b*) To determine the fair market value of an oil and/or gas property by the present value method, the essential factors must be determined for each deposit included in the property. The factors are (1) the total quantity of oil and/or gas in terms of the principal or customary unit (or units) paid for in the product marketed, (2) the quantity of oil and/or gas expected to be recovered during each operating period, (3) the average quality or grade of the oil and/or gas reserves, (4) the expected percentage of recovery in each process or operation necessary for the preparation of the oil and gas for market, (5) the probable operating life of the deposit in years, (6) the unit development cost, that is, cost of development exclusive of depreciation and depletion, (7) the unit operating cost, that is, cost of production exclusive of depreciation and depletion, and (8) the rate of interest commensurate with the risk for the particular deposit. When the deposit has been sufficiently developed these factors may be determined from past operating experience. In the application of factors derived from past experience full allowance should be made for probable future variations in the rate of exhaustion, quality or grade of the oil and/or gas, percentage of recovery, cost of development, production, interest rate, and selling price of the product marketed during the expected operating life of the oil and/or gas deposit.

(*c*) Oil and gas deposits for which these factors may not be determined with reasonable accuracy from past operating experience may, with the approval of the Commissioner, be valued in a similar manner; but the factors must be deduced from concurrent evidence, such as the general type of the deposit, the characteristics of the district in which it occurs, the habit of the oil and gas deposits in the property itself, the rate at which additional oil and gas have been disclosed by exploitation, the stage of the operating life of the property, and any other evidence tending to establish a reasonable estimate of the required factors.

(*d*) The oil content in the case of oil wells shall be determined in accordance with article 230, and the gas content in the case of gas wells in accordance with articles 232 and 233. The rate of exhaus-

tion of an oil or gas deposit should be determined by the character of the deposit, by the ability to market the oil and/or gas, by labor conditions, and by the operating program in force or reasonably to be expected at the basic date for future operations. The operating life of an oil and/or gas deposit is that number of years necessary for the exhaustion of the deposit at the rate determined by the actual or estimated rate of decline. The development cost includes expenditures for drilling wells to maintain or increase production or to develop additional unproven areas, and the cost of improvements necessary to the development of the property, such as roads, warehouses, water lines, etc. The operating cost includes all current expenditures for producing, preparing, and marketing the oil and/or gas produced, such as pumping oil wells, repairs of oil or gas wells, cleaning sanded wells, redrilling old wells, labor and supplies for collecting oil, repairs to separators, pumps, and collecting lines, repairs to buildings and structures, repairs to field tools, equipment, fixtures and machinery, superintendence, other field expenditures, overhead, etc. (due consideration being given to taxes), exclusive of allowable capital additions as defined in article 243 and deductions for depreciation and depletion. The cost of repairs is not to be confused with the depreciation deduction by which the cost or value of plant and equipment is returnable to the taxpayer free from tax. In general, no estimates of these factors will be approved by the Commissioner which are not supported by the operating experience of the property or which are derived from different and arbitrarily selected periods.

(*e*) The number of units of oil and/or gas recoverable in marketable form multiplied by the difference between the selling price and the operating cost per unit gives the total expected operating profit. The value of each oil or gas deposit is then the total expected operating profit from that deposit reduced to a present value as of the basic date at the rate of interest commensurate with the risk for the operating life, and further reduced by the value at the basic date of the depreciable assets and of the capital additions, if any, necessary to realize the profits. The degree of risk is generally lowest in cases where the factors of valuation are fully supported by the operating record of the oil and/or gas property prior to the basic date; relatively higher risks attach to appraisals upon any other basis.

ART. 228. **Revaluation of mineral deposits not allowed.**—No revaluation of a property whose value as of the basic date has been determined and approved will be made or allowed during the continuance of the ownership under which the value was so determined and approved, except in the case of a subsequent discovery as defined in

article 240, or of misrepresentation or fraud or gross error as to any facts determinable on the basic date. Revaluation on account of misrepresentation or fraud or such gross error will be made only with the written approval of the Commissioner. The value as of the basic date should, however, be corrected when a virtual change of ownership of part of the property results as the outcome of litigation, and should be redistributed—

(*a*) When a revision of the number of units of mineral in the property has been made in accordance with article 229, 230, or 232, and

(*b*) In case of the sale of a part of the property, between the part sold and the part retained.

ART. 229. **Determination of mineral contents of mine.**—Every taxpayer claiming a deduction for depletion of mines for a given year will be required to estimate or determine with respect to each separate property the total units (tons, pounds, ounces, or other measure) of mineral products reasonably known, or on good evidence believed, to have existed in the ground on the basic date, according to the method current in the industry and in the light of the most accurate and reliable information obtainable. In the selection of a unit of estimate, preference shall be given to the principal unit (or units) paid for in the product marketed. The estimate of the recoverable units of the mineral products in the property for the purposes of valuation and depletion shall include as to both quantity and grade—

(*a*) The ores and minerals "in sight," "blocked out," "developed," or "assured," in the usual or conventional meaning of these terms in respect to the type of the deposit, and

(*b*) "Probable" or "prospective" ores and minerals (in the corresponding sense), that is, ores and minerals that are believed to exist on the basis of good evidence although not actually known to occur on the basis of existing development; but "probable" or "prospective" ores and minerals may be estimated, for purposes of this valuation, (1) as to quantity, only in case they are extensions of known deposits or are new bodies or masses whose existence is indicated by geological or other evidence to a high degree of probability, and (2) as to grade, only as accords with the best indications available as to richness.

When information subsequently obtained clearly shows the estimate to have been materially erroneous, it may be revised with the approval of the Commissioner.

ART. 230. **Determination of quantity of oil in ground.**—In the case of either an owner or lessee it will be required that an estimate, subject

to the approval of the Commissioner, shall be made of the probable recoverable oil contained in the territory with respect to which the investment is made as of the basic date. The oil reserves must be estimated for all undeveloped proven land as well as producing land. When information subsequently obtained clearly shows the estimate to have been materially erroneous, it may be revised with the approval of the Commissioner.

ART. 231. **Computation of deduction for depletion of mineral deposits.**—(*a*) Depletion is allowable "according to the peculiar conditions in each case." When the depletion actually sustained, whether legally allowable or not, from the basic date equals the cost or value on the basic date plus subsequent allowable capital additions, no further deduction for depletion will be allowed except when the deduction is based upon discovery value or upon the income from the property. (See articles 222–224, 241, and 242.)

(*b*) When the value of the property at the basic date has been determined and the allowance is based upon such value, depletion sustained for the taxable year shall be computed by dividing the value remaining for depletion as of the beginning of the taxable year by the number of units of mineral to which this value is applicable, and by multiplying the unit value for depletion, so determined, by the number of units sold within the taxable year. Such depletion deduction is subject, however, to the limitation in article 221 (*h*). In the selection of a unit for depletion preference shall be given to the principal or customary unit or units paid for in the product sold.

ART. 232. **Computation of deduction for depletion of gas wells not based on the income from the property.**—On account of the peculiar conditions surrounding the production of natural gas it will be necessary to compute the depletion allowance for gas properties, when not based on the income from the respective properties, by methods suitable to the particular cases and acceptable to the Commissioner. Such depletion allowance in the case of natural gas properties may, when actual production is not known, be computed on the basis of decline in closed or rock pressure, taking into account the effects of water encroachment and any other modifying factors. The gas producer will be expected to compute the depletion as accurately as possible and submit with his return a description of the method by which the computation was made. The following formula, in which the units of gas are pounds per square inch of closed pressure, is recommended: The quotient of the capital account recoverable through depletion allowances to the end of the taxable year divided by the sum of the pressures at the beginning of the year plus the sum of initial pressures of new wells and less the sum of

the pressures at the time of expected abandonment (which quotient is the unit cost) multiplied by the sum of the pressures at the beginning of the taxable year plus the sum of the initial pressures of new wells and less the sum of the pressures at the end of the tax year equals the depletion sustained for the taxable year. If, however, the deduction is computed on the basis of the income from the property under section 114 (b) (3), see article 241.

ART. 233. **Gas well pressure records to be kept.**—Beginning with 1919 closed pressure readings of representative wells, if not of all wells, must be carefully made and kept. In order to standardize pressure readings the well should remain closed until the pressure does not build up more than 1 per cent of the total pressure in 10 minutes. Ordinarily 24 hours will suffice for this purpose, but some wells will need to remain closed for a longer period. If there is any water in the well it should be blown or pumped off before the well is closed. A closed pressure reading of a gas well which has been producing, or is near gas wells that have been producing, is lower than the actual pressure of the gas in the reservoir by an amount depending on the well's location with reference to other producing wells and the length of time it has been closed in. It is necessary to record the length of time the well has been closed and to show how the pressure built up during this period. Successive readings will indicate the point at which the pressure becomes approximately stationary; that is, the point at which the closed pressure approaches as nearly as possible the maximum pressure which would be shown if all wells in the pool were closed for several months. The length of time required varies with the character of the sand, position of the packer, the location of the well with reference to other wells, the limits of the pool, and other factors. The depth of the well, diameter of tubing, and line pressure when the well was shut off should be noted. Since readings at the exact end of the taxable year will ordinarily not be available, the pressure of that date may be obtained by interpolation or extrapolation. In certain cases readings taken regularly in September or some other month may be applicable to the end of the taxable year. As a general rule September closed pressure readings furnish the best indication of depletion, and it is recommended that such readings be made with regularity and care. Where interpolated or extrapolated readings are used, the data from which they are obtained should be given. Gauges should be of appropriate capacity and should be frequently tested. A record should be kept of the number of gauges, date each was tested, names of men testing, and other significant details.

ART. 234. **Computation of depletion allowance where quantity of oil or gas uncertain.**—If by reason of the youth of the field, the restricted production, or for any other cause, it is not possible to determine with any degree of certainty the quantity of oil or gas in a property, the deduction for depletion shall be based upon the income from the property.

ART. 235. **Computation of depletion allowance not based on the income from the property in the case of combined holdings of oil and gas wells.**—The recoverable oil belonging to the taxpayer shall be estimated for each property separately. The unit value of the recoverable oil and/or gas for each property is the quotient obtained by dividing the amount returnable through depletion for each property by the estimated number of units of recoverable oil and/or gas on that property. This unit for each separate property multiplied by the number of units of oil and/or gas produced by the taxpayer upon such property and sold within the year will determine the amount which may be deducted for depletion from the gross income of that year for that property. The total allowance for depletion of all the oil and/or gas properties of the taxpayer will be the sum of the amounts computed for each property separately. However, in the case of gas properties the depletion sustained for each pool may be computed by using the total amount returnable through depletion of all the tracts of gas land owned by the taxpayer in the pool. The total allowance for depletion in the gas properties of the taxpayer will be the sum of the amounts computed for each pool. If, however, the deduction is computed on the basis of the income from the property under section 114 (b) (3), see article 241.

ART. 236. **Depletion—Adjustments of accounts based on bonus or advanced royalty.**—(*a*) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received.

(*b*) Where the owner has leased a mineral property for a term of years with a requirement in the lease that the lessee shall extract and pay for, annually, a specified number of tons, or other agreed units of measurement, of such mineral, or shall pay, annually, a specified sum of money which shall be applied in payment of the

purchase price or royalty per unit of such mineral whenever the same shall thereafter be extracted and removed from the leased premises, the value in the ground to the lessor, for purposes of depletion, of the number of units so paid for in advance of extraction will constitute an allowable deduction from the gross income of the year in which such payment or payments shall be made; but no deduction for depletion by the lessor shall be claimed or allowed in any subsequent year on account of the extraction or removal in such year of any mineral so paid for in advance and for which deduction has once been made.

(*c*) If for any reason any such mineral lease expires or terminates or is abandoned before the mineral which has been paid for in advance has been extracted and removed, the lessor shall adjust his capital account by restoring thereto the depletion deductions made in prior years on account of royalties on mineral paid for but not removed, and a corresponding amount must be returned as income for the year in which the lease expires, terminates, or is abandoned.

(*d*) In lieu of the treatment provided for in the above paragraphs the lessor of oil and gas wells may take as a depletion deduction in respect of any bonus, royalties, and other income from the property for the taxable year 27½ per cent of the amount thereof, but the deduction shall not exceed 50 per cent of the net income (computed without allowance for depletion) from the property.

ART. 237. **Depletion and depreciation accounts on books.**—Every taxpayer claiming and making a deduction for depletion and depreciation of mineral property shall keep accurate accounts in which shall be charged the cost or the fair market value as of the basic date, as the case may be, of the mineral deposit and of the plant and equipment, together with subsequent allowable capital additions to each account.

When the plan or method of depletion and depreciation accounting adopted by the taxpayer has once been approved by the Commissioner, it can not be changed by the taxpayer without the consent of the Commissioner. These accounts shall thereafter be credited annually with the amounts of the depletion and depreciation sustained; or the amounts of the depletion and depreciation sustained shall be credited to depletion and depreciation reserve accounts, to the end that when the sum of the credits for depletion and depreciation equals the value or cost of the property, plus subsequent allowable capital additions, no further deductions for depletion and depreciation with respect to the property shall be allowed. See, however, section 114 (b) (3) and article 241 as to oil and gas wells.

ART. 238. **Statement to be attached to return when depletion or depreciation of mineral property is claimed.**—(*a*) To the return of every taxpayer claiming a deduction for depletion or depreciation there shall be attached a statement setting forth with respect to each mineral property: (1) Whether taxpayer is a fee owner, lessor, or lessee; (2) the date of acquisition and, if under lease, the exact terms and date of expiration of the lease; (3) the cost of the property, stating the amount paid to each vendor, with his name and address; (4) the basic date at which the property is valued; (5) the value of the property on the basic date with a statement of the precise method by which it was determined; (6) the value of the surface of the land for purposes other than mineral production; (7) the estimated number of units of mineral at the basic date with an explanation of the method used in the estimation, and an average analysis which will indicate the quality of the mineral valued; (8) the number of units sold during the year for which the return is made; (9) the gross and net income derived from the sale of mineral and in case of discovery of a mine the net income from the property upon which the discovery was made; (10) the amounts deducted for depletion; (11) the amounts sustained on account of depletion or on account of depreciation stated separately from the basic date to the taxable year; and (12) any other data which will be helpful in determining the reasonableness of a deduction based upon cost or value as of the basic date.

(*b*) To the return of every taxpayer claiming a deduction for depletion in respect of (1) property in which he owns a fractional interest only, or (2) a leasehold, or (3) property subject to lease, there shall also be attached a statement setting forth the name and address and the precise nature of the holding of each person interested in the property, and every lessor shall attach to his return an affidavit stating, as of the date of filing the return, whether the lease involved is still in effect during the year covered by the return, and, if not still in effect, when it was terminated and for what reason, and whether the lessor has repossessed the property.

(*c*) All statements required to be furnished in connection with the returns of taxpayers claiming depletion or depreciation must be under oath and may be included in a single affidavit.

ART. 239. **Additional statement to be attached to return where depletion of oil or gas is claimed.**—To each return made by a person owning or operating oil or gas properties there should be attached a statement showing for each property the following information, which may be given in the form of a table, if desired, by taxpayers owning more than one property:

(*a*) The cost or fair market value of the property (exclusive of machinery, equipment, etc., and the surface rights) as of the basic date;

(*b*) How the fair market value as of the basic date was ascertained;

(*c*) The estimated quantity of oil and/or gas in the property at the time of its purchase or when its value was determined;

(*d*) The name and address of the person making the estimate and the manner in which this estimate was made, including a summary of the calculations;

(*e*) The amount of capital applicable to each unit (this being found by dividing the cost or value, as the case may be, by the estimated number of units of oil and/or gas in the property as of the basic date);

(*f*) The quantity of oil and/or gas sold during the year for which the return is made (in the case of new properties it is desirable that this information be furnished by months);

(*g*) The number of acres of producing and proven oil and/or gas land;

(*h*) The number of wells producing at the beginning and end of the taxable year;

(*i*) The date of completion of wells finished during the taxable year;

(*j*) The date of abandonment of all wells abandoned during the taxable year;

(*k*) A property map showing the location of the property and of the producing and abandoned wells, dry holes, and proven oil and gas lands;

(*l*) The average gravity of the oil produced on the tract;

(*m*) The number of pay sands and average thickness of each pay sand or zone on the property;

(*n*) The average depth to the top of each of the different pay sands;

(*o*) Any data regarding change in operating conditions, such as flooding, use of compressed air, vacuum, shooting, etc., which have a direct effect on the production of the property;

(*p*) The monthly or annual production of individual wells and the initial daily production of new wells;

(*q*) For the first year in which the above information is filed for a property which was producing prior to the taxable year covered by the above statement the following information must be furnished: Annual production of the tract or of the individual wells, if the latter information is available, from the beginning of its

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productivity to the beginning of the taxable year for which the return was filed; the average number of wells producing during each year; and the initial daily production of each well; and

(*r*) Any other data which will be helpful in determining the reasonableness of a depletion deduction based upon cost or value as of the basic date.

When a taxpayer has filed adequate maps with the Commissioner he may be relieved of filing further maps of the same properties, provided all additional information necessary for keeping the maps up to date is filed each year. This includes records of dry holes, as well as producing wells, together with logs, depth and thickness of sands, location of new wells, etc. By "production" is meant the net production of oil or gas belonging to the taxpayer. In those leases where no account is kept of the oil or gas used for fuel, the production will necessarily be that remaining after the fuel used in the property has been taken out. In cases of this kind an estimate of the fuel used from each tract should be given for each year.

Where the allowance for depletion is based on the income from the property under section 114 (b) (3), the information required under the foregoing provisions of this article need not be furnished, except where it is necessary to determine gain or loss from the sale or other disposition of the property during the taxable year. For the purpose of computing the allowance for depletion upon the basis of the income derived from the property, there shall be submitted with the return a statement clearly showing the production, gross income, and net income (computed without allowance for depletion) from the property in respect of which the allowance for depletion is claimed, and explaining in detail the computation of such gross income and net income. (See article 221 (*i*).)

ART. 240. **Discovery of mines.**—(*a*) To entitle a taxpayer to a valuation of his property, for the purpose of depletion allowances, by reason of the discovery of a mine or minerals (other than oil or gas), it must appear that the mine or minerals were not acquired as the result of the purchase of a proven tract or lease; also, the discovery must be made by the taxpayer after February 28, 1913, and must result in the fair market value of the property becoming disproportionate to the cost. The fair market value of the property will be deemed to have become disproportionate to the cost when the newly discovered minerals are of such quantity and of such quality as to afford a reasonable expectation of return to the taxpayer of an amount materially in excess of the capital expended in making such discovery plus the cost of future development, equipment, and exploitation.

(*b*) A mine or minerals may be said to be discovered when (1) there is found a natural deposit of mineral, or (2) there is disclosed by drilling or exploration conducted above or below ground a mineral deposit not previously known to exist and so improbable that it had not been, and could not have been, included in any previous valuation for the purpose of depletion, and which in either case exists in quantity and grades sufficient to justify commercial exploitation.

(*c*) In determining whether a discovery entitling the taxpayer to a valuation has been made, the Commissioner will take into account the peculiar conditions of each case; but no discovery, for the purposes of depletion, can be allowed as to ores or minerals which constitute merely uninterrupted extensions of continuing commercial veins or deposits already known to exist, which have been or should have been included in "probable" or "prospective" ore or mineral, or which were in any other way comprehended in a prior valuation, nor can a discovery, for purposes of depletion, be allowed as of a date subsequent to that when, in fact, discovery was evident, when delay by the taxpayer in making claim therefor has resulted or will result in excessive allowances for depletion.

(*d*) Discoveries include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February 28, 1913, but such vein or deposit must not be merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and the newly discovered minerals must be of sufficient value and quantity that they could be separately mined and marketed at a profit.

(*e*) The value of property claimed as the result of a discovery must be the fair market value, as defined in article 226, based on what is evident within 30 days after the commercially valuable character and extent of the discovered deposits of ore or mineral have with reasonable certainty been established, determined, or proved.

(*f*) After a bona fide discovery the taxpayer shall adjust his capital and depletion accounts in accordance with articles 226, 229, and 231, and shall submit such evidence as to establish his right to a revaluation covering the conditions and circumstances of the discovery and the size, character, and location of the discovered deposit of mineral, the value of the property at the prior basic date, the cost of discovery, and its development, equipment, and exploitation, its value and the particular method used in the determination.

ART. 241. **Depletion in the case of oil and gas wells.**—Under section 114 (b) (3), in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income

from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. (See article 221 (*i*).) In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property or its value at the basic date, as the case may be. In general, "the property," as the term is used in section 114 (b) (3) and this article, refers to the separate tracts or leases of the taxpayer.

ART. 242. **Allowable capital additions in case of mines.**—(*a*) All expenditures in excess of net receipts from minerals sold shall be charged to capital account recoverable through depletion while the mine is in the development stage. The mine will be considered to have passed from a development to a producing status when the major portion of the mineral production is obtained from workings other than those opened for the purpose of development, or when the principal activity of the mine becomes the production of developed ore rather than the development of additional ores for mining.

(*b*) Expenditures for plant and equipment, not including expenditures for maintenance and for ordinary and necessary repairs, shall be charged to capital account recoverable through depreciation. (See articles 282 and 323.)

ART. 243. **Charges to capital and to expense in the case of oil and gas wells.**—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as a development expense or charged to capital account returnable through depletion and depreciation as in the case of productive wells. An election once made under this option will control the taxpayer's returns for all subsequent years. Where deductions for depreciation or depletion have either on the books of the taxpayer or in his returns of net income been included in the past in expense or other accounts, rather than specifically as depreciation or depletion, or where capital expenditures have been charged to expense in lieu of depreciation or depletion, a statement indicating the extent to which this practice has been carried should accompany the return.

ART. 244. **Depreciation in the case of mines.**—(*a*) The Act provides that deductions for depreciation of improvements "according to the peculiar conditions in each case" may be taken by a taxpayer owning or leasing mining property. This is deemed to include exhaustion and wear and tear of the property used in mining of deposits, including a reasonable allowance for obsolescence. (See articles 201–210.)

(*b*) It shall be optional with the taxpayer, subject to the approval of the Commissioner, (1) whether the cost or the value of the plant and equipment on the basic date plus allowable capital additions but minus estimated salvage value shall be recovered at a rate established by current exhaustion of mineral, or (2) whether the cost or value of the plant and equipment on the basic date plus allowable capital additions but minus estimated salvage value shall be recovered by reasonable charges for depreciation (see article 201) at a rate determined by the physical life or the economic life of such plant and equipment, or, according to the peculiar conditions of the case, by a method satisfactory to the Commissioner.

(*c*) The estimated physical life of a plant or unit thereof (including buildings, machinery, apparatus, roads, railroads, and other equipment and improvements whose principal use is in connection with the mining or treatment or other necessary handling of mineral products) may be defined as the estimated time such plant, or unit, when given proper care and repair, can be continued in use despite physical deterioration, decay, wear, and tear.

(*d*) The estimated economic life of a plant or unit thereof is the estimated time during which the plant or unit may be utilized effectively and economically for its intended purposes and may be limited by the life of the property or of that portion of the mineral deposits which it serves but can never exceed the physical life.

(*e*) Any difference between the salvage value of plant and equipment and the depreciated value remaining at the termination of mining operations shall be returned as profit or loss in the year in which it is realized.

(*f*) Nothing in these regulations shall be interpreted as meaning (1) that the cost or the value of a mining plant and equipment on the basic date may be reduced by depreciation deductions to a sum below the value of the salvage when the property shall have become obsolete or shall have been abandoned for the purpose of mining, or (2) that proper deductions for depreciation on account of obsolescence and decay shall not be made during periods when the mine is idle or is producing at a rate below its normal capacity. In estimating the salvage value of the equipment at the end of its estimated economic life due consideration may be given to its special-

ized character and the cost of dismounting and dismantling and transporting it to market.

(*g*) Nothing in these regulations shall be interpreted to permit expenditures charged to expense in any taxable year or any part of the value of land for purposes other than mining to be recovered through depletion or depreciation.

ART. 245. **Depreciation of improvements in the case of oil and gas wells.**—Both owners and lessees operating oil and/or gas properties will, in addition to and apart from the deduction allowable for depletion as hereinbefore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with the option exercised by the taxpayer under article 243. The amount deductible on this account shall be such an amount based upon its cost or other basis equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired. Accordingly, where it can be shown to the satisfaction of the Commissioner that the reasonable expectation of the economic life of the oil or gas deposit with which the property is connected is shorter than the normal useful life of the physical property, the amount annually deductible for depreciation on such property may be based upon the length of life of the deposit. (See articles 201–210.)

ART. 246. **Depletion and depreciation of oil and gas wells in years before 1916.**—If upon examination it is found that in respect of the entire drilling cost of wells, including physical property and incidental expenses, between March 1, 1913, and December 31, 1915, a taxpayer has been allowed a reasonable deduction sufficient to provide for the elements of exhaustion, wear and tear, and depletion, it will not be necessary to reopen the returns for years prior to 1916 in order to show separately in these years the portions of such deduction representing depletion and depreciation, respectively. Such separation will be required to be made of the reserves for depreciation at January 1, 1916, and proper allocation between depreciation and depletion must be maintained after that date.

ART. 247. **Depletion of timber.**—A reasonable deduction from gross income for the depletion of timber and for the depreciation of improvements is permitted, based upon the cost or other basis prescribed in section 113. The essence of this provision is that the owner of timber property, whether it be a leasehold or a freehold, shall secure through an aggregate of annual depletion and depreciation deductions a return of the capital invested by him in the property or an amount equal to its fair market value as of the basic date plus in any case subsequent allowable capital additions and minus cut-over land values.

ART. 248. **Capital recoverable through depletion allowance in the case of timber.**—In general, the capital remaining in any year recoverable through depletion allowances may be determined as indicated in articles 222–224. In the case of leases the apportionment of deductions between the lessor and lessee will be made as specified in articles 223 and 224. The cost of timber properties shall be determined in accordance with the principles indicated in article 225. For method of determining fair market value and quantity of timber, see articles 254–256. For depletion purposes the cost of the timber shall not include any part of the cost of the land.

ART. 249. **Computation of allowance for depletion of timber for given year.**—The allowance for depletion of timber in any taxable year shall be based upon the number of units of timber felled during the year and the unit value of the timber in the timber account or accounts pertaining to the timber cut. The unit value of the timber for a given timber account in a given year shall be the quotient obtained by dividing (*a*) the cost or the fair market value as of the basic date of the timber on hand at the beginning of the year plus the cost of the number of units acquired during the year plus proper additions to capital (see article 251) by (*b*) the total number of units of timber on hand in the given account at the beginning of the year plus the number of units acquired during the year plus (or minus) the number of units required to be added (or deducted) by way of correcting the estimate of the number of units remaining available in the account. The amount of the deduction for depletion in any taxable year with respect to a given timber account shall be the product of the number of units of timber cut from the given account during the year multiplied by the unit value of the timber for the given account for the year. Those taxpayers who keep their accounts on a monthly basis may, at their option, keep their depletion accounts on a monthly basis, in which case the amount deductible on account of depletion for a given month will be determined in the manner outlined above for a given year. The total amount of the deduction for depletion in any taxable year shall be the sum of the amounts deductible for the several timber accounts. For description of timber accounts, see articles 256 and 257.

The depletion of timber takes place at the time the timber is felled. Since, however, it is not ordinarily practicable to determine the quantity of timber immediately after felling, depletion for purposes of accounting will be treated as taking place at the time when, in

the process of exploitation, the quantity of timber is first definitely determined.

ART. 250. **Revaluation of timber not allowed.**—In the case of timber purchased prior to March 1, 1913, the fair market value as of that date or the cost, whichever is greater, shall, when determined and approved by the Commissioner, be the basis for determining the depletion deduction for each year during the continuance of the ownership under which the fair market value of the timber was fixed, and during such ownership there shall be no redetermination of the fair market value of the timber for such purpose, except in the case of misrepresentation, fraud, or gross error as to any facts determinable on the date of valuation. Revaluation on account of misrepresentation, fraud, or gross error will be made only with the written approval of the Commissioner. However, the unit market (or cost) value of the timber will subsequently be changed if from any cause such unit market (or cost) value, if continued as a basis of depletion, shall upon evidence satisfactory to the Commissioner be found inadequate or excessive for the extinguishment of the cost or fair market value as of March 1, 1913, of the timber.

ART. 251.[1] **Charges to capital and to expenses in the case of timber.**—In the case of a timber property held for future operation by an owner having no substantial income from the property or from other sources, all expenditures for administration, protection, and other carrying charges prior to production on a normal basis shall be charged to capital account; after such a property is on a normal production basis such expenditures shall be treated as current operating expenses. In case a taxpayer, who has a substantial income from other sources, owns a timber property which is not yet on a normal production basis he may charge such expenditures with respect to such timber property to capital or treat them as current operating expenses, but whichever system is adopted must be followed until permission to change to the other system is secured from the Commissioner. In the case of timber operations all expenditures for plants, improvements, and equipment shall be charged to capital account for purposes of depreciation.

ART. 252. **Depreciation of improvements in the case of timber.**—The cost or value as of the basic date, as the case may be, of development not represented by physical property having an inventory value shall be recoverable through depreciation. It shall be optional with the taxpayer, subject to the approval of the Commissioner—

(*a*) Whether the cost or value, as the case may be, of the property subject to depreciation shall be recovered at a rate established by current exhaustion of stumpage, or

[1] See T. D. 4320, p. 353.

(*b*) Whether the cost or value shall be recovered by appropriate charges for depreciation calculated by the usual rules for depreciation or according to the peculiar conditions of the taxpayer's case by a method satisfactory to the Commissioner.

In no case may charges for depreciation be based on a rate which will extinguish the cost or value of the property prior to the termination of its useful life. Nothing in these regulations shall be interpreted to mean that the value of a timber plant and equipment may be reduced by depreciation deductions to a sum below the value of the salvage when the plant and equipment shall have become obsolete or worn out or shall have been abandoned, or that any part of the value of cut-over land may be recoverable through depreciation.

ART. 253. **Information to be furnished by taxpayer claiming depletion of timber.**—To the income tax return of the taxpayer claiming a deduction for depletion or depreciation or both there shall be attached a map and statement (Form T–Timber) for the taxable year covered by the income tax return. Form T–Timber requires the following:

(*a*) Map showing timber and land acquired, timber cut, and timber and land sold;

(*b*) Description of, cost of, and terms of purchase or lease of, timber and land acquired;

(*c*) Proof of profit or loss from sale of capital assets;

(*d*) Description of timber with respect to which claim for loss, if any, is made;

(*e*) Record of timber cut;

(*f*) Changes in each timber account as the result of purchase, sale, cutting, reestimate, or loss;

(*g*) Changes in physical property accounts as the result of additions to or deductions from capital and depreciation;

(*h*) Operation data with respect to raw and finished material handled and inventoried;

(*i*) Unit production costs; and

(*j*) Any other data which will be helpful in determining the reasonableness of the depletion and/or depreciation deductions claimed in the return.

Similar information is required for certain years prior to the 1919 taxable year from those taxpayers who have not already furnished it. The specific nature of the information required for the earlier years is given in detail in Form T–General forest industries questionnaire for the years prior to 1919.

ART. 254. **Determination of fair market value of timber.**—Where the fair market value of the property at a specified date is the basis for depletion and depreciation deductions, such value shall be determined, subject to approval or revision by the Commissioner upon audit, by the owner of the property in the light of the most reliable and accurate information available with reference to the condition of the property as it existed at that date, regardless of all subsequent changes, such as changes in surrounding circumstances, in methods of exploitation, in degree of utilization, etc. The value sought will be the selling price, assuming a transfer between a willing seller and a willing buyer as of the particular date. Such factors as the following will be given due consideration:

(*a*) Character and quality of the timber as determined by species, age, size, condition, etc.;

(*b*) The quantity of timber per acre, the total quantity under consideration, and the location of the timber in question with reference to other timber;

(*c*) Accessibility of the timber (location with reference to distance from a common carrier, the topography and other features of the ground upon which the timber stands and over which it must be transported in process of exploitation, the probable cost of exploitation, and the climate and the state of industrial development of the locality); and

(*d*) The freight rates by common carrier to important markets.

The timber in each particular case will be valued on its own merits and not on the basis of general averages for regions; however, the value placed upon it, taking into consideration such factors as those mentioned above, will be consistent with that of the other timber in the region. The Commissioner will give due weight and consideration to any and all facts and evidence having a bearing on the market value, such as cost, actual sales and transfers of similar properties, the margin between the cost of production and the price realized for timber products, market value of stock or shares, royalties and rentals, value fixed by the owner for the purpose of the capital stock tax, valuation for local or State taxation, partnership accountings, records of litigation in which the value of the property has been involved, the amount at which the property may have been inventoried and/or appraised in probate or similar proceedings, disinterested appraisals by approved methods, and other factors. For depletion purposes the fair market value at a specified date shall not include any part of the value of the land.

ART. 255. **Determination of quantity of timber.**—Each taxpayer claiming or expecting to claim a deduction for depletion is required to

estimate with respect to each separate timber account the total units (feet board-measure, log scale, cords, or other units) of timber reasonably known, or on good evidence believed, to have existed on the ground on March 1, 1913, or on the date of acquisition of the property, as the case may be. This estimate shall state as nearly as possible the number of units which would have been found present by a careful estimate made on the specified date with the object of determining 100 per cent of the quantity of timber which the area would have produced on that date if all of the merchantable timber had been cut and utilized in accordance with the standards of utilization prevailing in that region at that time. If subsequently during the ownership of the taxpayer making the return, as the net result of the growth of the timber, of changes in standards of utilization, of losses not otherwise accounted for, of abandonment of timber, and/or of errors in the original estimates, there are found to remain on the ground, available for utilization, more or less units of timber than remain in the timber account or accounts, a new estimate of the recoverable units of timber (but not of the cost or the fair market value at a specified date) may be made, with the approval of the Commissioner, and, when made, shall thereafter constitute a basis for depletion.

ART. 256. **Aggregating timber and land for purposes of valuation and accounting.**—With a view to logical and reasonable valuation of timber, the taxpayer shall include his timber in one or more accounts. In general, each such account shall include all of the taxpayer's timber which is located in one "block," a block being an operation unit which includes all of the taxpayer's timber which would logically go to a single given point of manufacture. In those cases in which the point of manufacture is at a considerable distance, or in which the logs or other products will probably be sold in a log or other market, the block may be a logging unit which includes all of the taxpayer's timber which would logically be removed by a single logging development. In exceptional cases, provided there are good and substantial reasons, and subject to approval or revision by the Commissioner on audit, the taxpayer may divide the timber in a given block into two or more accounts, e. g., timber owned on February 28, 1913, and that purchased subsequently may be kept in separate accounts, or timber owned on February 28, 1913, and the timber purchased since that date in several distinct transactions may be kept in several distinct accounts, or individual tree species or groups of tree species may be carried in distinct accounts, or special timber products may be carried in distinct accounts, or blocks may be divided into two or more accounts based on the character of

the timber and/or its accessibility, or scattered tracts may be included in separate accounts. When such a division is made, a proper portion of the total value or cost, as the case may be, shall be allocated to each account.

The timber accounts mentioned in the preceding paragraph shall not include any part of the value or cost, as the case may be, of the land. In a manner similar to that prescribed in the foregoing part of this article the land in a given "block" may be carried in a single land account or may be divided into two or more accounts on the basis of its character and/or accessibility. When such a division is made, a proper portion of the total value or cost, as the case may be, shall be allocated to each account.

The total value or total cost, as the case may be, of land and timber shall be equitably allocated to the timber and land accounts, respectively.

Each of the several land and timber accounts carried on the books of the taxpayer shall be definitely described as to their location on the ground either by maps or by legal descriptions.

For good and substantial reasons to be approved by the Commissioner, or as required by the Commissioner, the timber or the land accounts may be readjusted by dividing individual accounts, by combining two or more accounts, or by dividing and recombining accounts.

ART. 257. **Timber depletion and depreciation accounts on books.**—Every taxpayer claiming or expecting to claim a deduction for depletion and/or depreciation of timber property (including plants, improvements, and equipment used in connection therewith) shall keep accurate ledger accounts in which shall be charged the cost or the fair market value as of the basic date, as the case may be, of the property, and the plants, improvements, and equipment, together with amounts subsequently expended for administration, protection, and other carrying charges, or development of the property or additions to plant and equipment as are not chargeable to current operating expenses. (See articles 251 and 254.)

In such accounts there shall be set up separately the quantity of timber, the quantity of land, and the quantity of other resources, if any, and a proper part of the total cost or value shall be allocated to each. (See article 256.) These accounts shall be credited with the amount of the depreciation and depletion deductions sustained each year, or the amount of the depreciation and depletion shall be credited to depreciation and depletion reserve accounts, to the end that when the sum of the credits for depreciation and depletion equals the cost or value of the property, plus the amount added

thereto for administration, protection, and other carrying charges, or development or for additional plant and equipment, less salvage value of the physical property, no further deduction for depreciation and depletion will be allowed.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME.]

[In computing net income there shall be allowed as deductions:]

(n) **Charitable and other contributions.**—In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

(1) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(3) the special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act;

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals;

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. (For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see section 120.)

ART. 261. **Contributions or gifts by individuals.**—Contributions or gifts made within the taxable year by an individual are deductible to an aggregate amount not in excess of 15 per cent of the taxpayer's net income (including such payments), if made to or for the use of:

(*a*) The United States, the District of Columbia, or any State or Territory or political subdivision thereof, for exclusively public purposes;

(*b*) Any corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, but only if no part of the net earnings

inures to the benefit of any private shareholder or individual (see article 527);

(*c*) The special fund for vocational rehabilitation authorized by section 7 of the Vocational Rehabilitation Act of June 27, 1918;

(*d*) Posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(*e*) A fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.

If, during the taxable year and each of the 10 preceding taxable years, the amount contributed in all the above cases combined plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years exceeds 90 per cent of the taxpayer's net income for each such year, as computed without the benefit of this article, the full amount of such contributions and gifts made within the taxable year is deductible. (See section 120.)

In connection with claims for deductions under this article, there shall be stated on returns of income the name and address of each organization to which a gift was made and the approximate date and the amount of the gift in each case. Where the gift is other than money, the basis for calculation of the amount thereof shall be the fair market value of the property at the time of the gift. His proportionate share of contributions made by a partnership may be claimed as a deduction in the personal return of a partner to an amount which, when added to the amount of contributions made by the partner individually and claimed as a deduction, is not in excess of 15 per cent of the partner's net income computed without the benefit of the deduction for contributions. As to deduction of contributions by partnerships, see section 183 and article 901. In the case of a nonresident alien individual or a citizen of the United States entitled to the benefits of section 251, see sections 213(c) and 251 and articles 1051 and 1133. This article does not apply to gifts by estates and trusts (see section 162 and article 862), nor does it apply to corporations.

ART. 262. **Donations by corporations.**—Corporations are not entitled to deduct from gross income contributions or gifts which individuals may deduct under section 23 (n). Donations made by a corporation for purposes connected with the operation of its business, however, when limited to charitable institutions, hospitals, or educational institutions conducted for the benefit of its employees or their dependents are a proper deduction as ordinary and necessary expenses. Donations which legitimately represent a consideration for a benefit flowing directly to the corporation as an incident of its business are allowable deductions from gross income. For example, a street railway corporation may donate a sum of money to an organization intending to hold a convention in the city in which it operates, with the reasonable expectation that the holding of such convention will augment its income through a greater number of people using the cars. Sums of money expended for lobbying purposes, the promotion or defeat of legislation, the exploitation of propaganda, including advertising other than trade advertising, and contributions for campaign expenses, are not deductible from gross income.

[SEC. 23. DEDUCTIONS FROM GROSS INCOME.]

[In computing net income there shall be allowed as deductions:]

(o) Future expenses in case of casual sales of real property.—In the case of a casual sale or other casual disposition of real property by an individual, a reasonable allowance for future expense liabilities, incurred under the provisions of the contract under which such sale or other disposition was made, under such regulations as the Commissioner, with the approval of the Secretary, may prescribe, including the giving of a bond, with such sureties and in such sum (not less than the estimated tax liability computed without the benefit of this subsection) as the Commissioner may require, conditioned upon the payment (notwithstanding any statute of limitations) of the tax, computed without the benefit of this subsection, in respect of any amounts allowed as a deduction under this subsection and not actually expended in carrying out the provisions of such contract.

(p) Dividends received by corporations.—In the case of a corporation, the amount received as dividends—

(1) from a domestic corporation, or

(2) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 119.

The deduction allowed by this subsection shall not be allowed in respect of dividends received from a corporation organized under the China Trade Act, 1922, or from a corporation which under section 251 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States.

(q) Pension trusts.—An employer establishing or maintaining a pension trust to provide for the payment of reasonable pensions to his

employees (if such trust is exempt from tax under section 165, relating to trusts created for the exclusive benefit of employees) shall be allowed as a deduction (in addition to the contributions to such trust during the taxable year to cover the pension liability accruing during the year, allowed as a deduction under subsection (a) of this section) a reasonable amount transferred or paid into such trust during the taxable year in excess of such contributions, but only if such amount (1) has not theretofore been allowable as a deduction, and (2) is apportioned in equal parts over a period of ten consecutive years beginning with the year in which the transfer or payment is made.

ART. 271.[1] **Payments to employees' pension trusts.**—An employer who adopts or has adopted a reasonable pension plan, actuarially sound, and who establishes, or has established, and maintains a pension trust for the payment of reasonable pensions to some or all of his employees (if the trust is exempt from tax under section 165, relating to trusts created for the exclusive benefit of employees) shall be allowed to deduct from gross income reasonable amounts paid to such trust, in accordance with the pension plan (or any reasonable amendment thereof), as follows:

(*a*) If the plan contemplates the payment to the trust, in advance of the time pensions are granted, of amounts to provide for future pension payments, then (1) amounts paid to the trust during the taxable year representing the pension liability applicable to such year, determined in accordance with the plan, shall be allowed as a deduction for such year as an ordinary and necessary business expense, and in addition (2) one-tenth of a reasonable amount transferred or paid to the trust during the taxable year to cover in whole or in part the pension liability applicable to the years prior to the taxable year, or so transferred or paid to place the trust on a sound financial basis, shall be allowed as a deduction for the taxable year and for each of the nine succeeding taxable years;

(*b*) If the plan does not contemplate the payment to the trust, in advance of the time pensions are granted, of amounts to provide for future pension payments, then (1) amounts paid to the trust during the taxable year representing the present value of the expected future payments in respect of pensions granted to employees retired during the taxable year shall be allowed as a deduction for such year as an ordinary and necessary business expense, and in addition (2) one-tenth of a reasonable amount transferred or paid to the trust during the taxable year to cover in whole or in part the present value of the expected future payments in respect of pensions granted to employees retired prior to the taxable year, or so transferred or paid to place the trust on a sound financial basis, shall

[1] See T. D. 4310, p. 354.

be allowed as a deduction for the taxable year and for each of the nine succeeding taxable years.

Reasonable payments made by an employer during the taxable year directly to pensioners on account of pensions in respect of which no payment has been made to a pension trust shall be allowed as a deduction from gross income for such year as an ordinary and necessary business expense.

In no case will any amount be allowed as a deduction under this article which was allowable as a deduction from gross income for any prior year. Where a deduction from gross income is claimed on account of payments to an employees' pension trust, a copy of the pension plan (with amendments, if any) and of the actuarial computation upon which the deduction is based, together with a detailed statement of the receipts and disbursements of the trust, should be filed with the return.

The right to a deduction under section 23 (q) will be recognized in cases where the pension trust may not be perpetual, provided the trust is of such a character as to evidence good faith on the part of the employer actually to pay the amounts trusteed for employees' pension purposes. However, should any portion of the funds of a pension trust revert to the possession, ownership, or control of the employer by reason of the termination of the trust or otherwise, such amount shall be returned as income by the employer for the taxable year in which it so reverts, unless prior to the close of such year it shall be retrusteed for the benefit of employees under provisions satisfactory to the Commissioner.

A pension trust maintained by affiliated corporations for the exclusive benefit of their employees is within the scope of sections 23 (q) and 165.

Example—Accruals in advance of pensions granted: In 1928 the M Company adopted a reasonable pension plan and established a pension trust which was exempt from tax under section 165. During the year and upon the basis of an actuarial computation the company paid $8,500,000 to the trust. At the time of the payment and in accordance with the pension plan of the company, the pension liability applicable to the years prior to 1928, in respect of employees then on the retired roll, for pensions to be paid in the future, was $2,000,000; the pension liability applicable to the years prior to 1928, in respect of employees on the active roll, for pensions to be paid in the future, was $6,500,000; the payment required to cover the pension liability applicable to the taxable year 1928 for pensions to be paid in the future, was $450,000. The amount paid to

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retired employees of the M Company by the pension trust as pensions during 1928 was $360,000.

The deduction for 1928 is computed as follows:

(a) Entire amount paid to pension trust representing the pension liability applicable to 1928 for pensions to be paid in the future	$450,000
(b) One-tenth of $8,500,000, amount transferred to pension trust to cover the pension liability applicable to the years prior to 1928, in respect of employees on either the retired roll or the active roll, for pensions to be paid in the future	850,000
Total deduction	1,300,000

The amount of $360,000 paid to pensioners is not allowable as a deduction for income tax purposes since it was paid by the pension trust and not by the M Company.

Example—Accruals on basis of pensions granted: In 1928 the N Company adopted a reasonable pension plan and established a pension trust which was exempt from tax under section 165. During the year and upon the basis of an actuarial computation the company paid $2,300,000 to the trust. At the time of the payment the present value of the expected future payments in respect of pensions granted to employees retired prior to 1928 was $2,000,000; the present value of the expected future payments in respect of pensions granted to employees retired during 1928 was $300,000. The amount paid to retired employees of the N Company by the pension trust as pensions during 1928 was $360,000.

The deduction for 1928 is computed as follows:

(a) Entire amount paid to the pension trust representing the present value of the expected future payments in respect of pensions granted to employees retired during 1928	$300,000
(b) One-tenth of $2,000,000, the amount transferred to the pension trust to cover the present value of the expected future payments in respect of pensions granted to employees retired prior to 1928	200,000
Total deduction	500,000

The amount of $360,000 paid to pensioners is not allowable as a deduction for income tax purposes, since it was paid by the pension trust and not by the N Company.

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) General rule.—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or

(4) Premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy.

(b) Holders of life or terminable interest.—Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act (except the deductions provided for in subsections (k) and (l) of section 23) for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

(c) Tax withheld on tax-free covenant bonds.—For tax withheld on tax-free covenant bonds, see section 144 (a) (4).

ART. 281. **Personal and family expenses.**—Insurance paid on a dwelling owned and occupied by a taxpayer is a personal expense and not deductible. Premiums paid for life insurance by the insured are not deductible. In the case of a professional man who rents a property for residential purposes, but incidentally receives clients, patients, or callers there in connection with his professional work (his place of business being elsewhere), no part of the rent is deductible as a business expense. If, however, he uses part of the house for his office, such portion of the rent as is properly attributable to such office is deductible. Where the father is legally entitled to the services of his minor children, any allowances which he gives them, whether said to be in consideration of services or otherwise, are not allowable deductions in his return of income. Alimony and an allowance paid under a separation agreement are not deductible from gross income. (See article 83.) The cost of equipment of an Army officer to the extent only that it is specially required by his profession and does not merely take the place of articles required in civilian life is deductible. Accordingly, the cost of a sword is an allowable deduction, but the cost of a uniform is not.

ART. 282. **Capital expenditures.**—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (k) and article 201.) Amounts expended for securing a copyright and plates, which remain the property of

the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities are an offset against the selling price. Expenses of the administration of an estate, such as court costs, attorneys' fees, and executors' commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an agreement between bondholders or shareholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. (See article 67.) An assessment paid by a shareholder of a national bank on account of his statutory liability is ordinarily not deductible but, subject to the provisions of the Act, may in certain cases represent a loss. Expenses of the organization of a corporation, such as incorporation fees, attorneys' and accountants' charges, are capital expenditures and not deductible from gross income. A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary.

ART. 283. **Premiums on business insurance.**—Premiums paid by a taxpayer on an insurance policy on the life of an officer, employee, or other individual financially interested in the taxpayer's business, for the purpose of protecting the taxpayer from loss in the event of the death of the officer or employee insured are not deductible from the taxpayer's gross income. If, however, the taxpayer is not a beneficiary under such a policy, the premiums so paid will not be disallowed as deductions merely because the taxpayer may derive a benefit from the increased efficiency of the officer or employee insured. (See articles 53 and 126–129.) In either case the proceeds of such policies paid by reason of the death of the insured may be excluded from gross income whether the beneficiary is an individual or a corporation, provided the beneficiary is not a transferee of the policy for a valuable consideration. (See section 22 (b) (1) and (2) and article 82.)

ART. 284. **Life or terminable interests.**—Amounts paid to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be subject to any deduction for shrinkage (whether

called depreciation or any other name) in the value of such interest due to the lapse of time. In other words, the holder of such an interest so acquired may not set up the value of the expected future payments as corpus or principal and claim deductions for shrinkage or exhaustion thereof due to the passage of time.

No deduction shall be allowed in the case of a life or terminable interest acquired by gift, bequest, or inheritance, where the estate or trust is entitled to a deduction under the Act but there is no reduction of the income of the life or terminable interest. For example, an estate or a trust in a certain State sells securities at a loss; if, under the laws of that State, the beneficiary suffers no actual loss, then even though the estate or trust is permitted to deduct such loss in making its return, the beneficiary whose income has not been diminished thereby is not entitled to a deduction on account of such loss, but must include in his return the full amount distributed or distributable. (See section 162 and article 862.) However, in the case of property held by one person for life with remainder to another person and in the case of property held in trust, see section 23 (k) and article 201 as to depreciation and section 23 (l) and article 221 as to depletion.

SEC. 25. CREDITS OF INDIVIDUAL AGAINST NET INCOME.

There shall be allowed for the purpose of the normal tax, but not for the surtax, the following credits against the net income:

(a) Dividends.—The amount received as dividends—

(1) from a domestic corporation, or

(2) from a foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119.

The credit allowed by this subsection shall not be allowed in respect of dividends received from a corporation organized under the China Trade Act, 1922, or from a corporation which under section 251 is taxable only on its gross income from sources within the United States by reason of its receiving a large percentage of its gross income from sources within a possession of the United States.

(b) Interest on United States obligations.—The amount received as interest upon obligations of the United States which is included in gross income under section 22.

(c) Personal exemption.—In the case of a single person, a personal exemption of $1,500; or in the case of the head of a family or a married person living with husband or wife, a personal exemption of $3,500. A husband and wife living together shall receive but one personal exemption. The amount of such personal exemption shall be $3,500. If such

husband and wife make separate returns, the personal exemption may be taken by either or divided between them.

(d) **Credit for dependents.**—$400 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer if such dependent person is under eighteen years of age or is incapable of self-support because mentally or physically defective.

(e) **Change of status.**—

(1) The credit for dependents shall be determined by the status of the taxpayer on the last day of his taxable year.

(2) The personal exemption allowed by subsection (c) of this section shall, in case the status of the taxpayer changes during his taxable year, be the sum of an amount which bears the same ratio to $1,500 as the number of months during which the taxpayer was single bears to twelve months, plus an amount which bears the same ratio to $3,500 as the number of months during which the taxpayer was a married person living with husband or wife or was the head of a family bears to twelve months. For the purposes of this paragraph a fractional part of a month shall be disregarded unless it amounts to more than half a month, in which case it shall be considered as a month.

(3) In the case of an individual who dies during the taxable year, the personal exemption and the credit for dependents shall be determined by his status at the time of his death, and in such case full credits shall be allowed to the surviving spouse, if any, according to his or her status at the close of the taxable year.

ART. 291. **Credits of individual against net income.**—(*a*) For the purpose of computing the normal tax the taxpayer's net income as determined pursuant to sections 21–24 is first reduced by the sum of the allowable credits. These include dividends (as defined in section 115 and article 621) received from a domestic corporation (other than a corporation entitled to the benefits of section 251, or other than a corporation organized under the China Trade Act, 1922), or from a foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per cent of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119 (see articles 671–684); interest not entirely exempt from tax (and hence included in gross income) received upon obligations of the United States; a personal exemption; and a credit for dependents. Consequently, the normal tax does not apply to the dividends just described nor to interest on any obligations of the United States. (See section 22 (b) (4) and articles 87 and 88.) For the purpose of computing the surtax the taxpayer's net income is entitled to none of these credits.

(*b*) A single person is entitled to a personal exemption of $1,500 and the head of a family or a married person living with husband or wife to $3,500, regardless of the amount of the net income. A husband and wife living together have but one personal exemption, which is $3,500. If they make separate returns, such exemption may be taken by either or divided between them.

ART. 292. **Personal exemption of head of family.**—A head of a family is an individual who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation. In the absence of continuous actual residence together, whether or not a person with dependent relatives is a head of a family within the meaning of the Act must depend on the character of the separation. If a father is absent on business, or a child or other dependent is away at school or on a visit, the common home being still maintained, the additional exemption applies. If, moreover, through force of circumstances a parent is obliged to maintain his dependent children with relatives or in a boarding house while he lives elsewhere, the additional exemption may still apply. If, however, without necessity the dependent continuously makes his home elsewhere, his benefactor is not the head of a family, irrespective of the question of support. A resident alien with children abroad is not thereby entitled to credit as the head of a family. As to the amount of the exemption, see article 291.

ART. 293. **Personal exemption of married person.**—In the case of a married man or married woman the joint exemption replaces the individual exemption only if the man lives with his wife or the woman lives with her husband. In the absence of continuous actual residence together, whether or not a man or woman has a wife or husband living with him or her within the meaning of the Act must depend on the character of the separation. If merely occasionally and temporarily a wife is away on a visit or a husband is away on business, the joint home being maintained, the additional exemption applies. The unavoidable absence of a wife or husband at a sanatorium or asylum on account of illness does not preclude claiming the exemption. If, however, the husband voluntarily and continuously makes his home at one place and the wife hers at another, they are not living together within the meaning of the Act, irrespective of their personal relations. A resident alien with a wife residing abroad is not entitled to the joint exemption.

ART. 294. **Credit for dependents.**—A taxpayer, other than a nonresident alien who is not a resident of Canada or Mexico (see section 214), receives a credit of $400 for each person (other than husband or wife), whether related to him or not and whether living with him or not, dependent upon and receiving his chief support from the taxpayer, provided the dependent is either (*a*) under 18, or (*b*) incapable of self-support because defective.

The credit is based upon actual financial dependency and not mere legal dependency. It may accrue to a taxpayer who is not the head of a family. But a father whose children receive half or more of their support from a trust fund or other separate source is not entitled to the credit.

ART. 295. **Date determining exemption.**—(*a*) The status of the taxpayer on the last day of his taxable year determines his right to the credit for dependents allowed by section 25 (d). If he is then the chief support of a dependent who is under 18 years of age, or who is incapable of self-support because mentally or physically defective, the credit for dependents may be taken.

(*b*) The credit allowed by section 25 (c) to a single person, a head of a family, or a married person living with husband or wife, will, in case the status of the taxpayer changes during the taxable year, be prorated according to the period during which the taxpayer occupied each status. The credit for any taxable year in such a case will thus be the sum of (1) an amount which bears the same ratio to $1,500 as the number of months the taxpayer was single bears to 12 months, plus (2) an amount which bears the same ratio to $3,500 as the number of months during which the taxpayer was a married person living with husband or wife or was the head of a family bears to 12 months. A fractional part of a month will be disregarded for this computation, unless it amounts to more than one-half month, in which case it will be considered to be a month.

Example: A, who had been single during the preceding months of 1928, married B on July 20 and lived with her during the balance of the year. If a joint return is made by A and B on a calendar year basis for 1928, the personal exemption will be $3,208.33; that is, $\frac{7}{12}$ of $1,500 for A while single, plus $\frac{7}{12}$ of $1,500 for B while single, plus $\frac{5}{12}$ of $3,500 for the period during which they were married. If separate returns are made by A and B on a calendar year basis for 1928, each may claim a personal exemption of $1,604.17; that is, $\frac{7}{12}$ of $1,500, plus $\frac{1}{2}$ of $\frac{5}{12}$ of $3,500. In the latter case, the joint exemption, or $\frac{5}{12}$ of $3,500, may be taken either by A or B or divided between them.

(*c*) If an individual dies during the taxable year, his executor or administrator in making a return for him is entitled to claim his full personal exemption according to his status at the time of his death. If a husband or wife so dies the joint personal exemption may be used by the executor or administrator in making a return for the decedent, and an undiminished personal exemption, according to the status of the survivor at the end of the taxable year, may be claimed in the survivor's return.

SEC. 26. CREDITS OF CORPORATION AGAINST NET INCOME.

For the purpose only of the tax imposed by section 13 there shall be allowed the following credits:

(a) The amount received as interest upon obligations of the United States which is included in gross income under section 22; and

(b) In the case of a domestic corporation the net income of which is $25,000 or less, a specific credit of $3,000; but if the net income is more than $25,000 the tax imposed by section 13 shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000.

ART. 301. **Credits allowed corporations.**—A corporation is entitled to a credit against net income for the purpose of the tax imposed by section 13 of the amount received as interest upon obligations of the United States which is included in gross income under section 22. Accordingly a corporation is not required to pay any income tax on interest received upon obligations of the United States.

A domestic corporation having a net income of $25,000 or less is allowed a credit of $3,000 against such net income for the purpose of the tax imposed by section 13. To lessen the inequality between the tax upon net income of $25,000 and upon net income slightly in excess of that amount, section 26 (b) provides that the tax shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000. This provision affects only those cases in which the net income is between $25,000 and $25,360 for the calendar year 1928 and subsequent years. See section 47 (e) for the manner of applying the $3,000 credit when a return is filed for a period of less than 12 months.

As to the allowance of credits against net income in the case of foreign corporations, see section 233.

PART III—CREDITS AGAINST TAX

SEC. 31. EARNED INCOME CREDIT.

(a) Definitions.—For the purposes of this section—

(1) "Earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services

actually rendered, but does not include that part of the compensation derived by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income producing factors, a reasonable allowance as compensation for the personal services actually rendered by the taxpayer, not in excess of 20 per centum of his share of the net profits of such trade or business, shall be considered as earned income.

(2) "Earned income deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against earned income.

(3) "Earned net income" means the excess of the amount of the earned income over the sum of the earned income deductions. If the taxpayer's net income is not more than $5,000, his entire net income shall be considered to be earned net income, and if his net income is more than $5,000, his earned net income shall not be considered to be less than $5,000. In no case shall the earned net income be considered to be more than $30,000.

(b) **Allowance of credit.**—In the case of an individual the tax shall be credited with 25 per centum of the amount of tax which would be payable if his earned net income constituted his entire net income; but in no case shall the credit allowed under this subsection exceed 25 per centum of his normal tax plus 25 per centum of the surtax which would be payable if his earned net income constituted his entire net income. This credit shall be in addition to all other credits against the tax.

ART. 311. **Earned income credit.**—In the case of an individual the tax shall, in addition to the credits provided in section 131 (see articles 691–698), be credited with 25 per cent of the amount of the tax which would be payable if his earned net income constituted his entire net income. In no case, however, shall this credit exceed 25 per cent of his normal tax plus 25 per cent of the surtax which would be payable if his earned net income constituted his entire net income. As to the earned income credit of the members of a partnership, see section 185 and article 921.

ART. 312. **Definitions and limitations.**—The term "earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered. In the case of a taxpayer engaged in a trade or business in which both personal services and capital are material income-producing factors, a reasonable allowance as compensation for the personal services actually rendered by the taxpayer shall be considered as earned income, but the total amount which shall be treated as the earned income of the taxpayer from such a trade or business shall, in no case, exceed 20 per

cent of his share of the net profits of such trade or business. See article 126 as to what constitutes compensation for personal services. The term does not include that part of any compensation received by the taxpayer for personal services rendered by him to a corporation which represents a distribution of earnings or profits rather than a reasonable allowance as compensation for the personal services actually rendered. No general rule can be laid down defining the trades or businesses in which personal services and capital are material income-producing factors, but this question must be determined with respect to the facts of the individual cases.

The term "earned income deductions" means deductions which are properly allocable to or chargeable against earned income and which are allowed by section 23 for the purpose of computing net income. The term "earned net income" means the excess of the amount of the earned income over the sum of the earned income deductions. In no case will the earned net income be considered to be more than $30,000. If the taxpayer's net income is not more than $5,000, his entire net income shall be considered to be earned net income, and if his net income is more than $5,000, his earned net income shall not be considered to be less than $5,000.

SEC. 32. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax, to the extent provided in section 131.

SEC. 33. TAXES WITHHELD AT SOURCE.

The amount of tax withheld at the source under section 144 shall be allowed as a credit against the tax.

SEC. 34. ERRONEOUS PAYMENTS.

(a) **Credit for overpayments.**—For credit against the tax of overpayments of taxes imposed by this title for other taxable years, see section 322.

(b) **Fiscal year ending in 1928.**—For credit against the tax of amounts of tax paid for a fiscal year beginning in 1927 and ending in 1928, see section 132.

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does

not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

ART. 321. **Computation of net income.**—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditures which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. (See articles 331–333.) If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

ART. 322. **Bases of computation.**—Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income. A method of accounting will not, however, be regarded as clearly reflecting income unless all items of gross income and all deductions are treated with reasonable consistency. See section 48 for definitions of "paid or accrued" and "paid or incurred." All items of gross income shall be included in the gross income for the taxable year in which they are received by the taxpayer, and deductions taken accordingly, unless in order clearly to reflect income such amounts are to be properly accounted for as of a different period. (See sections 42, 43, and 48.) For instance, in any case in which it is necessary to use an inventory, no accounting in regard to purchases and sales will correctly reflect income except an accrual method. A taxpayer is deemed to have received items of gross income which have been credited to or set apart for him without restriction. (See articles 332 and 333.) On the other hand, appreciation in value of property is not even an accrual of income to a taxpayer prior to the realization of such appreciation through sale or conversion of the property. But see article 105.

The true income, computed under the Revenue Act of 1928 and, where the taxpayer keeps books of account, in accordance with the method of accounting regularly employed in keeping such books (provided the method so used is properly applicable in determining the net income of the taxpayer for purposes of taxation), shall in all cases be entered in the return. If for any reason the basis of reporting income subject to tax is changed, the taxpayer shall attach to his return a separate statement setting forth for the taxable year and for the preceding year the classes of items differently treated under the two systems, specifying in particular all amounts duplicated or entirely omitted as the result of such change.

A taxpayer who changes the method of accounting employed in keeping his books for the taxable year 1928 or thereafter should, before computing his income upon such new basis for purposes of taxation, secure the consent of the Commissioner. Application for permission to change the basis of the return shall be made at least 30 days before the close of the period to be covered by the return and shall be accompanied by a statement specifying the classes of items differently treated under the two systems and specifying all amounts which would be duplicated or entirely omitted as a result of the proposed change.

Section 44 contains special provisions for reporting the profit derived from the sale of property on the installment plan. (See articles 351–355.)

The foregoing requirements relative to a change of accounting method are also applicable where a taxpayer desires to change from the installment basis of returning income, as provided in article 351, to a straight accrual basis. In cases where permission to make such change is granted, the taxpayer will be required to return as additional income for the taxable year in which the change is made all the profit not theretofore returned as income pertaining to the payments due on installment sales contracts as of the close of the preceding taxable year.

ART. 323. **Methods of accounting.**—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. (See section 54 and article 411.) Among the essentials are the following:

(1) In all cases in which the production, purchase, or sale of merchandise of any kind is an income-producing factor, inventories of

the merchandise on hand (including finished goods, work in process, raw materials, and supplies) should be taken at the beginning and end of the year and used in computing the net income of the year (see section 22 (c) and articles 101–108);

(2) Expenditures made during the year should be properly classified as between capital and expense; that is to say, expenditures for items of plant, equipment, etc., which have a useful life extending substantially beyond the year should be charged to a capital account and not to an expense account; and

(3) In any case in which the cost of capital assets is being recovered through deductions for wear and tear, depletion, or obsolescence any expenditure (other than ordinary repairs) made to restore the property or prolong its useful life should be added to the property account or charged against the appropriate reserve and not to current expenses.

ART. 324. **Accounting period.**—The return of a taxpayer is made and his income computed for his taxable year, which means his fiscal year, or the calendar year if he has not established a fiscal year. The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December. No fiscal year will, however, be recognized unless before its close it was definitely established as an accounting period by the taxpayer and the books of such taxpayer were kept in accordance therewith. The taxable year 1928 is the calendar year 1928 or any fiscal year ending during the calendar year 1928. (See section 48.) A person having no such fiscal year must make return on the basis of the calendar year. Except in the case of a first return for income tax a taxpayer shall make his return on the basis (fiscal or calendar year) upon which he made his return for the taxable year immediately preceding unless, with the approval of the Commissioner, he has changed his accounting period.

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

ART. 331. **When included in gross income.**—Gains, profits, and income are to be included in the gross income for the taxable year in which they are received by the taxpayer, unless they are included as of a different period in accordance with the approved method of accounting followed by him. (See articles 321–323.) Where no determination of compensation is had until the completion of the services, the amount received is ordinarily income for the taxable year of its determination, if the return is rendered on the accrual basis; or, for the taxable year in which received, if the return is rendered on the receipts and disbursements basis. If a person sues in one year on a pecuniary claim or for property, and money or property is recovered on a judgment therefor in a later year, income is realized in that year, assuming that the money or property would have been income in the earlier year if then received. This is true of a recovery for patent infringement. Bad debts or accounts charged off subsequent to March 1, 1913, because of the fact that they were determined to be worthless, which are subsequently recovered, whether or not by suit, constitute income for the year in which recovered, regardless of the date when the amounts were charged off. (See article 191.) Such items as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined.

ART. 332. **Income not reduced to possession.**—Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. Where a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

ART. 333. **Examples of constructive receipt.**—When interest coupons have matured and are payable, but have not been cashed, such interest, though not collected when due and payable, shall be included in gross income for the year during which the coupons mature, unless it can be shown that there are no funds available for payment of the interest during such year. The interest shall be included in gross income even though the coupons are exchanged for other property instead of eventually being cashed. Defaulted coupons are income for the year in which paid. Dividends on corporate stock are subject to tax when unqualifiedly made subject to the demand of the shareholder. As to the distributive share of the profits of a partner

in a partnership, see section 182 and article 902. Interest credited on savings bank deposits, even though the bank nominally has a rule, seldom or never enforced, that it may require so many days' notice before withdrawals are permitted, is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, has a taxable status as income for the year of the credit. Where the amount of such accumulations does not become available to the shareholder until the maturity of a share, the amount of any share in excess of the aggregate amount paid in by the shareholder is income for the year of the maturity of the share. But see section 22 (b) (7).

ART. 334. **Long-term contracts.**—Income from long-term contracts is taxable for the period in which the income is determined, such determination depending upon the nature and terms of the particular contract. As used herein the term "long-term contracts" means building, installation, or construction contracts covering a period in excess of one year. Persons whose income is derived in whole or in part from such contracts may, as to such income, prepare their returns upon the following bases:

(*a*) Gross income derived from such contracts may be reported upon the basis of percentage of completion. In such case there should accompany the return certificates of architects or engineers showing the percentage of completion during the taxable year of the entire work to be performed under the contract. There should be deducted from such gross income all expenditures made during the taxable year on account of the contract, account being taken of the material and supplies on hand at the beginning and end of the taxable period for use in connection with the work under the contract but not yet so applied. If, upon completion of a contract, it is found that the taxable net income arising thereunder has not been clearly reflected for any year or years, the Commissioner may permit or require an amended return.

(*b*) Gross income may be reported in the taxable year in which the contract is finally completed and accepted if the taxpayer elects as a consistent practice so to treat such income, provided such method clearly reflects the net income. If this method is adopted there should be deducted from gross income all expenditures during the life of the contract which are properly allocated thereto, taking into consideration any material and supplies charged to the work under the contract but remaining on hand at the time of completion.

Where a taxpayer has filed his return in accordance with the method of accounting regularly employed by him in keeping his

books and such method clearly reflects the income, he will not be required to change to either of the methods above set forth. If a taxpayer desires to change his method of accounting in accordance with paragraphs (*a*) and (*b*) of this article, a statement showing the composition of all items appearing upon his balance sheet and used in connection with the method of accounting formerly employed by him, should accompany his return.

ART. 335. **Subtraction for redemption of trading stamps.**—Where a taxpayer, for the purpose of promoting his business, issues with sales trading stamps or premium coupons redeemable in merchandise or cash, he should in computing the income from such sales subtract only the amount which will be required for the redemption of such part of the total issue of trading stamps or premium coupons issued during the taxable year as will eventually be presented for redemption. This amount will be determined in the light of the experience of the taxpayer in his particular business and of other users of trading stamps or premium coupons engaged in similar businesses. The taxpayer shall file for each of the five preceding years, or such number of these years as stamps or coupons have been issued by him, a statement showing—

(*a*) The total issue of stamps during each year;

(*b*) The total stamps redeemed in each year; and

(*c*) The percentage for each year of the stamps redeemed to the stamps issued in such year.

A similar statement shall also be presented showing the experience of other users of stamps or coupons whose experience is relied upon by the taxpayer to determine the amount to be subtracted from the proceeds of sales. The Commissioner will examine the basis used in each return, and in any case in which the amount subtracted in respect of such stamps or coupons is found to be excessive an amended return or amended returns will be required.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

ART. 341. **"Paid or incurred" and "paid or accrued."**—The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48 (c).) The

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deductions and credits provided for in Title I must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Act, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

ART. 342. **When charges deductible.**—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year. (But see section 117 and articles 651–655.) A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. If subsequent to its occurrence, however, a taxpayer first ascertains the amount of a loss sustained during a prior taxable year which has not been deducted from gross income, he may render an amended return for such preceding taxable year including

such amount of loss in the deductions from gross income and may file a claim for refund of the excess tax paid by reason of the failure to deduct such loss in the original return. (See section 322 and articles 1251–1257.) A loss from theft or embezzlement occurring in one year and discovered in another is ordinarily deductible for the year in which sustained.

SEC. 44. INSTALLMENT BASIS.

(a) **Dealers in personal property.**—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) **Sales of realty and casual sales of personalty.**—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 40 per centum of the selling price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

(c) **Change from accrual to installment basis.**—If a taxpayer entitled to the benefits of subsection (a) elects for any taxable year to report his net income on the installment basis, then in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded.

(d) **Gain or loss upon disposition of installment obligations.**—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and (1) in the case of satisfaction at other than face value or a sale or exchange—the amount realized, or (2) in case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full.

ART. 351. **Sale of personal property on installment plan.**—Dealers in personal property ordinarily sell either for cash or on the personal credit of the purchaser or on the installment plan. Dealers who

sell on the installment plan usually adopt one of four ways of protecting themselves in case of default—

(*a*) By an agreement that title is to remain in the vendor until the purchaser has completely performed his part of the transaction;

(*b*) By a form of contract in which title is conveyed to the purchaser immediately, but subject to a lien for the unpaid portion of the selling price;

(*c*) By a present transfer of title to the purchaser, who at the same time executes a reconveyance in the form of a chattel mortgage to the vendor; or

(*d*) By conveyance to a trustee pending performance of the contract and subject to its provisions.

The general purpose and effect being the same in all of these cases, the same rule is uniformly applicable. The general rule prescribed is that a person who regularly sells or otherwise disposes of personal property on the installment plan, whether or not title remains in the vendor until the property is fully paid for, may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the total or gross profit (that is, sales less cost of goods sold) realized or to be realized when the property is paid for, bears to the total contract price. Thus the income of a dealer in personal property on the installment plan may be ascertained by taking as income that proportion of the total payments received in the taxable year from installment sales (such payments being allocated to the year against the sales of which they apply) which the total or gross profit realized or to be realized on the total installment sales made during each year bears to the total contract price of all such sales made during that respective year. No payments received in the taxable year shall be excluded in computing the amount of income to be returned on the ground that they were received under a sale the total profit from which was returned as income during a taxable year or years prior to the change by the taxpayer to the installment basis of returning income. But in the case of any taxpayer who, by an original return made prior to February 26, 1926, changed the method of reporting his net income for the taxable year 1924 or any prior taxable year to the installment basis, see section 705. Deductible items are not to be allocated to the years in which the profits from the sales of a particular year are to be returned as income, but must be deducted for the taxable year in which the items are paid or incurred or paid or accrued, as provided by sections 43 and 48. A dealer who desires to compute his income on the installment basis shall

maintain books of account in such a manner as to enable an accurate computation to be made on such basis in accordance with the provisions of this article.

In the case of a casual sale or other casual disposition of personal property other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, for a price exceeding $1,000, income may be returned on the installment basis provided the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale or other disposition is made do not exceed 40 per cent of the selling price.

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper allowance for damage and use, if any, will be income of the vendor for the year in which the property is repossessed, and the property repossessed must be carried on the books of the vendor at its original cost, less proper allowance for damage and use, if any.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible.

If an installment obligation is satisfied, or otherwise disposed of, gain or loss may result therefrom and must be determined in accordance with section 44 (d) and article 355.

ART. 352. **Sale of real property involving deferred payments.**—Under section 44 deferred-payment sales of real property fall into two classes when considered with respect to the terms of sale, as follows:

(1) Sales of property on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made do not exceed 40 per cent of the selling price.

(2) Deferred-payment sales not on the installment plan, that is, sales in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed 40 per cent of the selling price.

Sales falling within class (1) and class (2) alike include (*a*) agreements of purchase and sale which contemplate that a conveyance is not to be made at the outset, but only after all or a substantial portion of the selling price has been paid, and (*b*) sales where there is an immediate transfer of title, the vendor being protected by a mortgage or other lien as to deferred payments.

In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the "selling price," but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as a part of the "initial payments" or of the "total contract price," as those terms are used in section 44, in articles 351 and 353, and in this article. Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the "initial payments," the "total contract price," or the "selling price."

ART. 353. **Sale of real property on installment plan.**—In transactions included in class (1) in article 352 the vendor may return as income from such transactions in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the property is paid for bears to the total contract price.

If for any reason the purchaser defaults in any of his payments, and the vendor returning income on the installment basis repossesses the property, the entire amount received in installment payments and retained by the vendor, less the sum of the profits previously returned as income and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property while in the hands of the purchaser, will be income of the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the installment sale.

If the vendor chooses as a matter of consistent practice to return the income from installment sales on the straight accrual or cash receipts and disbursements basis, such a course is permissible, and the sales will be treated as deferred-payment sales not on the installment plan.

ART. 354. **Deferred-payment sale of real property not on installment plan.**—In transactions included in class (2) in article 352, the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the profit or loss from the transaction.

If the vendor had retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property by agreement or process of law, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor and (2) the sum of the profits previously returned as income in connection therewith and an amount repre-

senting proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property while in the hands of the purchaser, will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the sale. If the vendor had previously transferred title to the purchaser, and the purchaser defaults in any of his payments and the vendor reacquires the property, such repossession shall be regarded as a transfer by the vendor, in exchange for the property, of such of the purchaser's obligations as are applied by the vendor to the purchase or bid price of the property. Such an exchange will be regarded as having resulted in the realization by the vendor of gain or loss, as the case may be, for the year of repossession, measured by the difference between the fair market value of the property and the basis in the hands of the vendor of the obligations of the purchaser (generally, the fair market value thereof which was previously recognized in computing income) which were applied by the vendor to the purchase or bid price of the property. The fair market value of the property shall be presumed to be the amount for which it is bid in by the vendor in the absence of clear and convincing proof to the contrary. If the property so acquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

If the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and, if in excess of such basis, shall be taxable to the extent of the excess. Gain or loss is realized when the obligations are disposed of or satisfied, the amount being the difference between the reduced basis as provided above and the amount realized therefor. Only in rare and extraordinary cases does property have no fair market value.

ART. 355. **Gain or loss upon disposition of installment obligations.**—If an installment obligation is satisfied at other than its face value or is sold or exchanged, gain or loss results to the extent of the difference between (1) the excess of the face value of the obligation over the amount of income which would be returnable were the obligation satisfied in full and (2) the amount realized upon such disposition.

If an installment obligation is distributed, transmitted, or disposed of otherwise than by sale or exchange, gain or loss results to the extent of the difference between (1) the excess of the face value of the obligation over the amount of income which would be returnable were the obligation satisfied in full and (2) the fair market value of

the obligation at the time of such distribution, transmission, or disposition.

The entire amount of gain or loss resulting from the disposition or satisfaction of installment obligations shall be recognized except as provided in section 112 and articles 571–580.

Example (1): In 1928 the M Corporation sold a piece of real estate to B for $20,000. The company acquired the property subsequent to February 28, 1913, at a cost of $10,000. During 1928 the company received $5,000 cash and the vendee's notes for the remainder of the selling price, or $15,000, payable in subsequent years. Before the vendee made any further payments the company sold the notes for $13,000 in cash. The company derived taxable income in the amount of $5,500 from the sale of the notes, computed as follows:

Proceeds of sale of notes		$13,000
Selling price of property	$20,000	
Cost of property	10,000	
Total profit to be realized when property is paid for	10,000	
Total contract price	20,000	
Per cent of profit, or proportion of each payment returnable as income, $10,000 divided by $20,000, 50 per cent		
Face value of notes	$15,000	
Amount of income returnable were the notes satisfied in full, 50 per cent of $15,000	7,500	
Excess of face value of note over amount of income returnable were the notes satisfied in full		7,500
Taxable income derived from sale of notes		5,500

Example (2): Suppose in the example given above the M Corporation, instead of selling the notes, distributed them to its shareholders as a dividend, and at the time of such distribution the fair market value of the notes was $14,000. The company would derive taxable income in the amount of $6,500 from such disposition of the notes, computed as follows:

Fair market value of notes		$14,000
Excess of face value of notes over amount of income returnable were the notes satisfied in full (computed as in example (1))		7,500
Taxable income derived from disposition of notes		6,500

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among

such trades or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such trades or businesses.

SEC. 46. CHANGE OF ACCOUNTING PERIOD.

If a taxpayer changes his accounting period from fiscal year to calendar year, from calendar year to fiscal year, or from one fiscal year to another, the net income shall, with the approval of the Commissioner, be computed on the basis of such new accounting period, subject to the provisions of section 47.

ART. 361. **Change in accounting period.**—If a taxpayer changes his accounting period he shall, prior to the expiration of 30 days from the close of the proposed period for which a return would be required to effect the change, furnish to the collector, for transmission to the Commissioner, the information required on Form 1128. The due date of the separate return for such period is the fifteenth day of the third month following the close of that period. If the change in the basis of computing the net income of the taxpayer is approved by the Commissioner, the taxpayer shall thereafter make his returns and compute his net income upon the basis of the new accounting period. (See section 47 and article 371.)

SEC. 47. RETURNS FOR A PERIOD OF LESS THAN TWELVE MONTHS.

(a) **Returns for short period resulting from change of accounting period.**—If a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year.

(b) **Income computed on basis of short period.**—Where a separate return is made under subsection (a) on account of a change in the accounting period, and in all other cases where a separate return is required or permitted, by regulations prescribed by the Commissioner with the approval of the Secretary, to be made for a fractional part of a year, then the income shall be computed on the basis of the period for which separate return is made.

(c) **Income placed on annual basis.**—If a separate return is made under subsection (a) on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made, shall be placed on an annual basis by multiplying

the amount thereof by twelve and dividing by the number of months included in the period for which the separate return is made. The tax shall be such part of the tax computed on such annual basis as the number of months in such period is of twelve months.

(d) **Capital net gains and losses—earned income.**—The Commissioner with the approval of the Secretary shall by regulations prescribe the method of applying the provisions of subsections (b) and (c) (relating to computing income on the basis of a short period, and placing such income on an annual basis) to cases where the taxpayer makes a separate return under subsection (a) on account of a change in the accounting period, and it appears that for the period for which the return is so made he has derived a capital net gain, or sustained a capital net loss, or received earned income.

(e) **Reduction of credits against net income.**—In the case of a return made for a fractional part of a year, except a return made under subsection (a), on account of a change in the accounting period, the personal exemption and credit for dependents, and the specific credit for corporations, shall be reduced respectively to amounts which bear the same ratio to the full credits provided as the number of months in the period for which return is made bears to twelve months.

(f) **Closing of taxable year in case of jeopardy.**—For closing of taxable year in case of jeopardy, see section 147.

ART. 371. **Returns for periods of less than 12 months.**—No return can be made for a period of more than 12 months. A separate return for a fractional part of a year is therefore required wherever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year. The periods to be covered by such separate returns in the several cases are stated in the Act. The requirements with respect to the filing of a separate return and the payment of tax for a part of a year are the same as for the filing of a return and the payment of tax for a full taxable year closing at the same time. (See sections 53 and 56 and articles 401–404, 431, and 746.) The tax on net income computed on the basis of the period for which a separate return is made shall be paid thereon at the rate for the calendar year in which such period is included. Where a return is made for a fractional part of a year, except where a return is made for a period of less than 12 months by reason of a change in accounting period, the personal exemption and credit for dependents, and the credit of $3,000 allowed a domestic corporation having a net income not exceeding $25,000, shall be reduced to that proportion of the full credit which the number of months in the period for which the return is made bears to 12 months.

In case of a change in accounting period the net income computed on the return for the fractional part of a year shall be placed on an annual basis and the tax computed as provided in section 47 (c).

Where the net income of a corporation is placed on an annual basis, the amount of the net income after being placed on such basis determines whether the credit of $3,000 is allowable.

Example (1): The income tax of a citizen of the United States entitled to a personal exemption of $3,500, making a return for a six-months period by reason of a change in accounting period, and having a net income of $10,000 for such six-months period, of which $5,000 is earned net income, is $406.87, computed as follows:

Net income	$10,000.00
Multiplied by 12	120,000.00
Divided by 6	20,000.00
Subtracting exemption of $3,500	16,500.00
Normal tax on $16,500	605.00
Surtax on $20,000	220.00
Total	825.00
Divided by 2	412.50
Less credit for earned income	5.63
Amount of tax	406.87

Example (2): The income tax of a domestic corporation making a return for a six-months period by reason of a change in accounting period, and having a net income of $10,000 for such six-months period, is $1,020, computed as follows:

Net income	$10,000
Multiplied by 12	120,000
Divided by 6	20,000
Subtracting credit of $3,000 (allowable because net income placed on annual basis does not exceed $25,000)	17,000
Tax on $17,000 at 12 per cent	2,040
Amount of tax ($2,040÷2)	1,020

The return of a decedent or of his estate for the year in which he died is a return for 12 months and not for a fractional part of a year.

SEC. 48. DEFINITIONS.

When used in this title—

(a) **Taxable year.**—"Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. "Taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1928, shall be the calendar year 1928 or any fiscal year ending during the calendar year 1928.

(b) **Fiscal year.**—"Fiscal year" means an accounting period of twelve months ending on the last day of any month other than December.

(c) **Paid, incurred, accrued.**—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

PART V—RETURNS AND PAYMENT OF TAX

SEC. 51. INDIVIDUAL RETURNS.

(a) **Requirement.**—The following individuals shall each make under oath a return stating specifically the items of his gross income and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,500 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $3,500 or over, if married and living with husband or wife; and

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income.

(b) **Husband and wife.**—If a husband and wife living together have an aggregate net income for the taxable year of $3,500 or over, or an aggregate gross income for such year of $5,000 or over—

(1) Each shall make such a return, or

(2) The income of each shall be included in a single joint return, in which case the tax shall be computed on the aggregate income.

(c) **Persons under disability.**—If the taxpayer is unable to make his own return, the return shall be made by a duly authorized agent or by the guardian or other person charged with the care of the person or property of such taxpayer.

(d) **Fiduciaries.**—For returns to be made by fiduciaries, see section 143.

ART. 381. **Individual returns.**—For each taxable year every single person and every married person not living with husband or wife, whose gross income as defined in sections 22 and 116 is $5,000 or over, or whose net income as defined in section 21 is $1,500 or over, must make a return of income. The return shall be for his taxable year, whether calendar or fiscal. Whether or not an individual is the head of a family or has dependents is immaterial in determining his liability to render a return. A husband and wife living together for the entire year need make no returns unless their aggregate gross income for the taxable year is at least $5,000, or their aggregate net income is at least $3,500. If their aggregate net income for the taxable year is $3,500 or more, or their aggregate gross income is $5,000 or more, either each must make a return, or the income of each must be included in a single joint return. A husband and wife living together for a period which is less than the

entire taxable year must make a return or returns if their aggregate gross income for the taxable year is $5,000 or more, or their aggregate net income is equal to, or in excess of, the credit allowed them by section 25 (e) (2). (See article 295.) Where the income of each is included in a single joint return, the tax is computed on the aggregate income and all deductions and credits to which either is entitled shall be taken from such aggregate income. The husband shall include in his return the income derived from services rendered by the wife or from the sale of products of her labor if she does not file a separate return or join with him in a return setting forth her income separately. A joint return of husband and wife may be filed only if they were living together at the close of their taxable year. Where one spouse dies prior to the last day of the taxable year, the surviving spouse should not include the income of the deceased spouse in a joint return for such taxable year. For returns by fiduciaries, see section 143 and articles 741–746; by partnerships, see section 189 and articles 941 and 942; and by nonresident alien individuals, see section 217 and article 1081. See also section 53 and articles 401–404.

ART. 382. **Form of return.**—The return shall be on Form 1040, except that it may be on short Form 1040 A where the net income does not exceed $5,000, and is derived chiefly from salaries and wages. The forms may be had from the collectors of the several districts. The return may be made by an agent when, by reason of illness, absence, or nonresidence, the person liable for the return is unable to make it, the agent assuming the responsibility for making the return and incurring liability for the penalties provided for erroneous, false, or fraudulent returns.

ART. 383. **Return of income of minor.**—An individual under the statutory age of majority is required to render a return of income if he has a net income of his own of $1,500 or over, or a gross income of $5,000 or over, for the taxable year. If he is married, see article 381. If a minor has been emancipated by his parent, his earnings are his own income, and such earnings, regardless of amount, are not required to be included in the return of the parent. If the aggregate of the net income of a minor from any property which he possesses, and from any funds held in trust for him by a trustee or guardian, and from his earnings in case he has been emancipated, is at least $1,500, or his gross income is at least $5,000, a return as in the case of any other individual must be made by him or by his guardian, or some other person charged with the care of his person or property for him. (See article 742.) In the absence of

proof to the contrary, a parent will be assumed to have the legal right to the earnings of the minor and must include them in his return.

ART. 384. **Verification of returns.**—All income tax returns must be verified under oath or affirmation. The oath or affirmation may be administered by any officer duly authorized to administer oaths for general purposes by the law of the United States or of any State, Territory, or possession of the United States, wherein such oath is administered, or by a consular officer of the United States. Persons in the naval or military service of the United States may verify their returns before any official authorized to administer oaths for the purposes of those services. Income tax returns executed abroad may be attested free of charge before United States consular officers. Where a foreign notary or other official having no seal shall act as attesting officer, the authority of such attesting officer should be certified to by some judicial official or other proper officer having knowledge of the appointment and official character of the attesting officer.

ART. 385. **Use of prescribed forms.**—Copies of the prescribed return forms will so far as possible be furnished taxpayers by collectors. A taxpayer will not be excused from making a return, however, by the fact that no return form has been furnished to him. Taxpayers not supplied with the proper forms should make application therefor to the collector in ample time to have their returns prepared, verified, and filed with the collector on or before the due date. Each taxpayer should carefully prepare his return so as fully and clearly to set forth the data therein called for. Imperfect or incorrect returns will not be accepted as meeting the requirements of the Act. In lack of a prescribed form a statement made by a taxpayer disclosing his gross income and the deductions therefrom may be accepted as a tentative return, and if filed within the prescribed time a return so made will relieve the taxpayer from liability to penalties, provided that without unnecessary delay such a tentative return is replaced by a return made on the proper form. (See further articles 402–404.)

SEC. 52. CORPORATION RETURNS.

(a) **Requirement.**—Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on

the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

(b) **Consolidated returns.**—For provision as to consolidated returns of affiliated corporations, see sections 141 and 142.

ART. 391. **Corporation returns.**—Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations, the return shall be on Form 1120. For returns of insurance companies, see article 1015; of foreign corporations, see section 235; and of affiliated corporations, see sections 141 and 142 and articles 711 and 731. A corporation having an existence during any portion of a taxable year is required to make a return. A corporation which has received a charter, but has never perfected its organization, which has transacted no business and had no income from any source, may upon presentation of the facts to the collector be relieved from the necessity of making a return so long as it remains in an unorganized condition. In the absence of a proper showing to the collector such a corporation will be required to make a return. A corporation which was dissolved in 1928 prior to the enactment of the Revenue Act of 1928 is not relieved from the necessity of rendering returns thereunder for any period or periods of its existence for which the Act is effective. For information returns by corporations relating to profits of the taxable year declared as dividends, see section 149 (b). For verification of returns and use of prescribed forms, see articles 384 and 385. Upon liquidation or dissolution of a corporation there shall be attached to the final return a statement showing: (1) The date and manner of dissolution, (2) the name and address of each shareholder at dissolution and the number and par value of the shares of stock held by each of them, (3) a description and the value of the liquidating assets received by each shareholder, (4) the name and address of each individual or corporation other than shareholders and creditors, if any, that received assets at dissolution, (5) a description and the value of the assets received by each such individual or corporation, and (6) the consideration, if any, paid by each of them for the assets received.

ART. 392. **Returns by receivers.**—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on Form 1120, covering each year or part of a year during which they are in control. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver,

trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. (See sections 274 and 298 and articles 1191 and 1192.) A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income.

SEC. 53. TIME AND PLACE FOR FILING RETURNS.

(a) Time for filing.—

(1) GENERAL RULE.—Returns made on the basis of the calendar year shall be made on or before the 15th day of March following the close of the calendar year. Returns made on the basis of a fiscal year shall be made on or before the 15th day of the third month following the close of the fiscal year.

(2) EXTENSION OF TIME.—The Commissioner may grant a reasonable extension of time for filing returns, under such rules and regulations as he shall prescribe with the approval of the Secretary. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

(b) To whom return made.—

(1) INDIVIDUALS.—Returns (other than corporation returns) shall be made to the collector for the district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in the United States, then to the collector at Baltimore, Maryland.

(2) CORPORATIONS.—Returns of corporations shall be made to the collector of the district in which is located the principal place of business or principal office or agency of the corporation, or, if it has no principal place of business or principal office or agency in the United States, then to the collector at Baltimore, Maryland.

ART. 401. **Time for filing returns.**—Returns of income (except in the case of nonresident alien individuals, as to which see section 217, and foreign corporations, as to which see section 235) must be made on or before the 15th day of the third month following the close of the fiscal or calendar year. A corporation going into liquidation during any taxable year may, upon the completion of such liquidation, prepare a return for that year covering its income for the part of the year during which it was engaged in business and may immediately file such return with the collector.

ART. 402. **Extensions of time for filing returns.**—It is important that the taxpayer render on or before the due date a return as complete and final as it is possible for him to prepare. However, the Commissioner is authorized to grant a reasonable extension of time for

filing returns under such rules and regulations as he shall prescribe with the approval of the Secretary. Accordingly, authority for granting extensions of time for filing income tax returns is hereby delegated to the various collectors of internal revenue. Application for extensions of time for filing income tax returns should be addressed to the collector of internal revenue for the district in which the taxpayer files his returns and must contain a full recital of the causes for the delay. Except in the case of taxpayers who are abroad, no extension for filing income tax returns may be granted for more than six months. For extensions of time for payment of tax, see sections 56 (c) and 272 (j) and articles 403, 432, and 1173.

ART. 403. **Extensions of time in the case of foreign organizations, certain domestic corporations, and citizens of United States residing or traveling abroad.**—An extension of time for filing returns of income for 1928 and subsequent taxable years is hereby granted up to and including the fifteenth day of the sixth month following the close of the taxable year in the case of:

(*a*) Foreign partnerships regardless of whether or not they maintain an office or place of business within the United States;

(*b*) Foreign corporations which maintain an office or place of business within the United States;

(*c*) Domestic corporations which transact their business and keep their records and books of account abroad;

(*d*) Domestic corporations whose principal income is from sources within the possessions of the United States; and

(*e*) American citizens residing or traveling abroad, including persons in military or naval service on duty outside the United States.

In all such cases an affidavit must be attached to the return, stating the cause of the delay in filing.

An extension of time for paying the tax for such years is also granted up to and including the fifteenth day of the sixth month following the close of the taxable year in the case of the taxpayers specified in (*c*), (*d*), and (*e*). The installments of tax which are actually due must be paid at the time of filing the return and the other installments shall be paid as they fall due. Taxpayers who take advantage of this extension of time for paying the tax will be charged with interest at the rate of 6 per cent per annum on the first installment of tax from the original due date until paid. As to the date on which tax shall be paid by foreign corporations, see section 236 and article 1121.

ART. 404. **Due date of return.**—The due date is the date on or before which a return is required to be filed in accordance with the provisions of the Act or the last day of the period covered by an

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extension of time granted by the Commissioner or a collector. When the due date falls on Sunday or a legal holiday, the due date for filing returns will be the day following such Sunday or legal holiday. If placed in the mails, the returns should be posted in ample time to reach the collector's office, under ordinary handling of the mails, on or before the date on which the return is required to be filed. If a return is made and placed in the mails in due course, properly addressed and postage paid, in ample time to reach the office of the collector on or before the due date, no penalty will attach should the return not actually be received by such officer until subsequent to that date. Where a question may be raised as to whether the return was posted in ample time to reach the collector's office on or before the due date, the envelope in which the return was transmitted will be preserved by the collector and forwarded to the Commissioner with the return. As to additions to the tax in the case of failure to file return within the prescribed time, see section 291 and article 1211.

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) **By taxpayer.**—Every person liable to any tax imposed by this title or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

(b) **To determine liability to tax.**—Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath such statements, or keep such records, as the Commissioner deems sufficient to show whether or not such person is liable to tax under this title.

(c) **Information at the source.**—For requirement of statements and returns by one person to assist in determining the tax liability of another person, see sections 148 to 151.

ART. 411. **Aids to collection of tax.**—In assessing and collecting income taxes the Commissioner has the benefit of all existing internal revenue laws in so far as such laws are applicable. The Commissioner may require any person to keep specific records, render under oath such statements and returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe in order that he may determine whether such person is liable for the tax or for the collection thereof. In accordance with this provision, every person subject to tax carrying on the business of producing, manufacturing, purchasing, or selling any commodities or merchandise, except the business of growing and selling products of the soil, shall for the purpose of determining the amount of income which may be subject to the tax keep such permanent books of account or records, including inventories, as are

necessary to establish the amount of his gross income and the deductions, credits, and other information required to be shown in an income tax return.

SEC. 55. PUBLICITY OF RETURNS.

Returns made under this title shall be open to inspection in the same manner, to the same extent, and subject to the same provisions of law, including penalties, as returns made under Title II of the Revenue Act of 1926.

ART. 421. **Inspection of returns.**—Section 55 provides that returns made under Title I shall be open to inspection in the same manner, to the same extent, and subject to the same provisions of law, including penalties, as returns made under Title II of the Revenue Act of 1926. Accordingly, the inspection of returns made under Title I is governed by the provisions of sections 257 and 1203 (d) of the Revenue Act of 1926, which are as follows:

RETURNS TO BE PUBLIC RECORDS.

SEC. 257. (a) Returns upon which the tax has been determined by the Commissioner shall constitute public records; but, except as hereinafter provided in this section and section 1203, they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President. Whenever a return is open to the inspection of any person a certified copy thereof shall, upon request, be furnished to such person under rules and regulations prescribed by the Commissioner with the approval of the Secretary. The Commissioner may prescribe a reasonable fee for furnishing such copy.

(b) (1) The Secretary and any officer or employee of the Treasury Department, upon request from the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, or a select committee of the Senate or House specially authorized to investigate returns by a resolution of the Senate or House, or a joint committee so authorized by concurrent resolution, shall furnish such committee sitting in executive session with any data of any character contained in or shown by any return.

(2) Any such committee shall have the right, acting directly as a committee, or by or through such examiners or agents as it may designate or appoint, to inspect any or all of the returns at such times and in such manner as it may determine.

(3) Any relevant or useful information thus obtained may be submitted by the committee obtaining it to the Senate or the House, or to both the Senate and the House, as the case may be.

(c) The proper officers of any State may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe.

(d) All bona fide shareholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making

request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries. Any shareholder who pursuant to the provisions of this section is allowed to examine the return of any corporation, and who makes known in any manner whatever not provided by law the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both.

(e) The Commissioner shall as soon as practicable in each year cause to be prepared and made available to public inspection in such manner as he may determine, in the office of the collector in each internal-revenue district and in such other places as he may determine, lists containing the name and the post-office address of each person making an income-tax return in such district.

[SEC. 1203.] (d) The Joint Committee shall have the same right to obtain data and to inspect returns as the Committee on Ways and Means or the Committee on Finance, and to submit any relevant or useful information thus obtained to the Senate, the House of Representatives, the Committee on Ways and Means, or the Committee on Finance. The Committee on Ways and Means or the Committee on Finance may submit such information to the House or to the Senate, or to both the House and the Senate, as the case may be.

The returns upon which the tax has been determined by the Commissioner, although public records, are open to inspection only to the extent authorized by the President except as otherwise expressly provided. The President by an Executive order dated July 23, 1928, ordered that returns filed under Title I of the Revenue Act of 1928 shall be open to inspection in accordance and upon compliance with rules and regulations prescribed by the Secretary of the Treasury and approved by the President, bearing date of April 13, 1926, and the amendment thereto dated July 23, 1928. Such regulations as amended are as follows:[1]

1. These regulations deal only with inspection of returns in so far as it is necessary for the President to approve regulations on this subject. Other uses to which returns may be lawfully put, without action by the President, are not covered by these regulations.

2. The word "corporation" when used alone herein shall, unless otherwise indicated, include corporations, associations, joint-stock companies, and insurance companies. The word "return" when so used shall, unless otherwise indicated, include income and profits tax returns, and also special excise tax returns of corporations filed pursuant to section 1000, Title X, of each of the Revenue Acts of 1918 and 1921, and pursuant to section 700 of Title VII of the Revenue Act of 1924.

3. Written statements filed with the Commissioner of Internal Revenue designed to be supplemental to and to become a part of tax returns shall be subject to the same rules and regulations as to inspection as are the tax returns themselves.

[1] See T. Ds. 4264, 4291, and 4317, pp. 354–355.

4. Except as hereinafter specifically provided, the Commissioner of Internal Revenue may, in his discretion, upon written application setting forth fully the reasons for the request, grant permission for the inspection of returns in accordance with these regulations. The officers and employees of the Treasury Department whose official duties require inspection of returns may inspect any such returns without making such written application.

5. The return of an individual shall be open to inspection (*a*) by the person who made the return, or by his duly constituted attorney in fact; (*b*) if the maker of the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; and (*c*) in the discretion of the Commissioner of Internal Revenue, by any heir at law or next of kin of such deceased person, upon a showing that such heir at law or next of kin has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

6. A joint return of a husband and wife shall be open to inspection (*a*) by either spouse for whom the return was made, upon satisfactory evidence of such relationship being furnished, or by his or her duly constituted attorney in fact; (*b*) if either spouse has died, by the administrator, executor, or trustee of his or her estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; and (*c*) in the discretion of the Commissioner of Internal Revenue, by any heir at law or next of kin of such deceased spouse, upon a showing that such heir at law or next of kin has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

7. The return of a partnership shall be open to inspection (*a*) by any individual who was a member of such partnership during any part of the time covered by the return upon satisfactory evidence of such fact being furnished, or by his duly constituted attorney in fact; (*b*) if a member of such partnership during any part of the time covered by the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; and (*c*) in the discretion of the Commissioner of Internal Revenue, by any heir at law or next of kin of such deceased person, upon a showing that such heir at law or next of kin has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

8. The return of an estate shall be open to inspection (*a*) by the administrator, executor, or trustee of such estate, or by his duly constituted attorney in fact; and (*b*) in the discretion of the Commissioner of Internal Revenue, by any heir at law or next of kin of the deceased person for whose estate the return is made, upon a showing of material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

9. The return of a trust shall be open to inspection (*a*) by the trustee or trustees, jointly or severally, or the duly constituted attorney in fact of such trustee or trustees; (*b*) by any individual who was a beneficiary of such trust during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished, or by his duly constituted attorney in fact; (*c*) if any individual who was a beneficiary of such trust during any part of the time

covered by the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor or trustee; and (*d*) in the discretion of the Commissioner of Internal Revenue, by any heir at law or next of kin of such deceased person, upon a showing that such heir at law or next of kin has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law or next of kin.

10. The return of a corporation shall be open to inspection by the president, vice president, secretary, or treasurer of such corporation, or, if none, by any of its principal officers, upon satisfactory evidence of identity and official position, or by the duly constituted attorney in fact of such officer. The return of a corporation which has since been dissolved, shall, in the discretion of the Commissioner of Internal Revenue, be open to inspection to any person who under these regulations might have inspected the return at the date of dissolution.

11. The "access" to returns of corporations provided for in subdivision (c) of section 257 shall be considered as inspection of returns within the meaning of subdivision (a) of said section.

12. The "examination" of returns of corporations provided for in subdivision (d) of section 257 shall be considered as inspection of returns within the meaning of subdivision (a) of said section.

13. When the head of an executive department (other than the Treasury Department) or any other United States Government establishment desires to inspect or to have some other officer or employee of his branch of the service inspect a return in connection with some matter officially before him, the inspection may, in the discretion of the Secretary of the Treasury, be permitted upon written application to him by the head of such executive department or other Government establishment. The application must be signed by such head and must show in detail why the inspection is desired, the name and address of the taxpayer who made the return, and the name and official designation of the one it is desired shall inspect the return. When the head of a bureau or office in the Treasury Department, not a part of the Internal Revenue Bureau, desires to inspect a return in connection with some matter officially before him, other than an income, profits tax, or corporation excise tax matter, the inspection may, in the discretion of the Secretary, be permitted upon written application to him by the head of such bureau or office, showing in detail why the inspection is desired.

14. In the case of returns or copies thereof furnished by the Department for use in legal proceedings, only such inspection as necessarily results from such use is permitted.

15. Except as provided in paragraph 14 returns may be inspected only in the office of the Commissioner of Internal Revenue, Washington, D. C., unless such returns are in the custody of a collector of internal revenue or internal revenue agent in charge, in which event the return may be inspected in the office of such collector or agent, but only in the presence of an internal revenue officer designated by the collector or agent for that purpose. When the returns are in the custody of a collector of internal revenue or internal revenue agent in charge, such collector of internal revenue or internal revenue agent in charge is authorized to grant permission for the inspection of such returns in accordance with these regulations.

16. A person who, under these regulations, is permitted to inspect a return may make and take a copy thereof or a memorandum of data contained therein.

17. By section 3167, Revised Statutes, as amended by the Revenue Act of 1918, and reenacted without change in section 1311 of the Revenue Act of 1921 and in section 1018 of the Revenue Act of 1924 and in section 1115 of the Revenue Act of 1926, it is made a misdemeanor for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures, appearing in any income return, which misdemeanor is punishable by a fine not exceeding $1,000 or by imprisonment not exceeding one year or both, at the discretion of the court, and if the offender be an officer or employee of the United States, by dismissal from office or discharge from employment.

18. All former regulations issued with the approval of the President in respect of inspection of returns are hereby withdrawn.

19. These regulations shall remain in force until expressly withdrawn or overruled.

ART. 422. **Furnishing of copies of income returns.**—(1) The original income return of an individual, partnership, corporation, association, joint-stock company, insurance company, or fiduciary, or a copy thereof, may be furnished by the Commissioner to a United States attorney for use as evidence before a United States grand jury or in litigation in any court, where the United States is interested in the result, or for use in the preparation for such litigation, or to an attorney connected with the Department of Justice designated to handle such matters, upon written request of the Attorney General, the Assistant to the Attorney General, or an Assistant Attorney General. When an income return or copy thereof is thus furnished, it must be limited in use to the purpose for which it is furnished and is under no conditions to be made public except where publicity necessarily results from such use. If the income return is in the custody of a collector or of an internal revenue agent in charge, a copy thereof may be furnished by the collector or by the internal revenue agent in charge to a United States attorney for use as evidence before a United States grand jury or in litigation in any court where the United States is interested in the result, or for use in the preparation of such litigation. Where a photostat is requested and the collector or the internal revenue agent in charge has not the available facilities for making such copy, written request for the copy must be sent to the Commissioner at Washington. In case the original return is necessary, it shall be placed in evidence by the Commissioner or by some other officer or employee of the Internal Revenue Bureau designated by the Commissioner for that purpose, and after it has been placed in evidence it shall be returned to the files from which it was withdrawn. An original return will be furnished only in

exceptional cases, and then only when it is made to appear that the ends of justice may otherwise be defeated. Neither the original nor a copy of an income return desired for use in litigation in court will be furnished, where the United States Government is not interested in the result and where such use might result in making public the information contained therein, whether or not the request for the copy is contained in an order of the court. This provision is not a limitation on the use of copies of returns by the persons entitled to such copies under the provisions of the succeeding paragraph.

(2) A copy of an income return may be furnished by the Commissioner to the person who made the return or to his duly constituted attorney; or if the person is deceased, to his executor or administrator; or if the person is in the hands of a receiver, trustee in bankruptcy, guardian, or similar legal custodian, to the receiver, trustee, guardian, or other similar custodian upon written application for same, accompanied by satisfactory evidence that the applicant comes within this provision. "The person who made the return," as herein used, refers in the case of an individual return to the individual, a copy of whose return is desired, and in the case of a return of a corporation, association, joint-stock company, insurance company, or fiduciary, to the corporation, association, joint-stock company, insurance company, or fiduciary, a copy of whose return is desired. A corporation, association, joint-stock company, or insurance company may designate by proper action of its board of directors or other similar governing body, the officer or individual to whom a copy of a return made by the corporation, association, joint-stock company, or insurance company may be furnished, and upon sufficient evidence of such action and of the identity of the officer or individual, a copy may be furnished to such person. A copy of a partnership income return may be furnished to any individual (or his duly constituted attorney in fact or legal representative) who was a member of such partnership during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished. A copy of a corporation income return may be furnished to a shareholder entitled to inspect the return upon submission of the evidence required by article 424. The copy of the return will, however, be furnished only to the shareholder and he will not be permitted to delegate another to receive it in his behalf. In the case of a corporation which has been dissolved, a copy of the return of the corporation may be furnished to any person who could have received a copy at the date of dissolution. A copy of an income return in the custody of a collector or of an internal revenue agent in charge may be furnished by the collector or by the internal

revenue agent in charge to a person entitled to receive a copy of such return under this paragraph upon written application for same, accompanied by satisfactory evidence that the applicant comes within its provisions. Where a photostat is requested and the collector or the internal revenue agent in charge has not the available facilities for making such copy, the written request for the copy must be sent to the Commissioner at Washington.

(3) A copy of an income return may be furnished to any person who may be permitted to inspect the return as provided in article 421.

(4) Certified copies of returns will be furnished to the persons entitled thereto only upon written request for same sent to the Commissioner at Washington.

(5) The Commissioner may prescribe a reasonable fee for furnishing copies of returns.

ART. 423. **Access to returns by State officers.**—(1) The proper officers of a State are entitled as of right upon the request of its governor to have access to the income and profits tax returns of a corporation or to an abstract thereof, showing its name and income.

(2) The request or application of the governor must be in writing, signed by him under the seal of his State, and must show: (*a*) The name and address of the corporation making the returns to which access is desired; (*b*) why access is desired; (*c*) the names and official positions of the officers designated to have the access.

(3) The request or application of the governor may be addressed either to the Secretary of the Treasury or to the Commissioner, but should be transmitted to the Commissioner, who will set a convenient time and place for the access to the returns (or to an abstract thereof as he may determine).

(4) Access shall be given only in the office of the Commissioner, unless such returns are in the custody of a collector of internal revenue or internal revenue agent in charge, in which event the return may be inspected in the office of such collector or agent, but only in the presence of an internal revenue officer designated by the collector or agent for that purpose.

(5) The officers designated by the governor will not be permitted to name another person or persons to examine the returns (or abstracts) for them.

(6) The officers designated may have access to lists furnished to supplement and become a part of the returns to which they are given access.

(7) The proper officers of a State may have access to the capital stock tax returns filed under the provisions of section 700 of the

Revenue Act of 1924 and section 1000 of the Revenue Acts of 1918 and 1921 under the same conditions prescribed in the preceding paragraphs for access to the income and profits tax returns of corporations.

ART. 424. **Examination of returns by shareholder.**—A bona fide shareholder of record owning 1 per cent or more of the outstanding stock of a corporation shall be entitled as of right, upon making request of the Commissioner, to examine the annual income returns of such corporation and of its subsidiaries, and all returns of such corporation and subsidiaries filed for purposes of the tax imposed by section 1000 of the Revenue Acts of 1918 and 1921, or by section 700 of the Revenue Act of 1924. His request for permission to examine such returns must be made in writing, and must be in the form of an affidavit showing his address, the name of the corporation, the period of time covered by the return he desires to inspect, the amount of the corporation's outstanding capital stock, the number of shares owned by him, the date when he acquired them, and whether he has the beneficial as well as the record title to such shares. It must also show that he has not acquired his shares for the purpose of the examination of the income returns of the corporation. If he has acquired them for such purpose, he is not a bona fide shareholder within the meaning of the statute. The application must be supported by satisfactory evidence showing that the applicant is a bona fide shareholder of record of the required amount of stock of the corporation. The supporting evidence may be partly in the form of a certificate signed by the president or vice president of the corporation and countersigned by the secretary under the corporate seal. Upon being satisfied from the evidence presented that the applicant has fully met these conditions, the Commissioner will grant the permission to examine the returns and set a convenient time and place for the examination. This privilege is personal and will be granted only to the shareholder, who can not delegate it to another.

ART. 425. **Penalties for disclosure of returns.**—A shareholder who examines the return of a corporation and reveals without express authority of law any particular of its income statement is guilty of a misdemeanor and liable to fine and imprisonment. Section 3167 of the Revised Statutes, as amended by the Revenue Act of 1918 and reenacted without change by section 1115 of the Revenue Act of 1926, provides as follows:

> SEC. 3167. It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer

> or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employment.

An internal revenue officer discovering in the course of his duty information leading him to suspect a possible violation of any law with the enforcement of which he is not directly concerned should immediately report the matter to the Commissioner, who is authorized to communicate with the proper department involved.

SEC. 56. PAYMENT OF TAX.

(a) **Time of payment.**—The total amount of tax imposed by this title shall be paid on the fifteenth day of March following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the third month following the close of the fiscal year.

(b) **Installment payments.**—The taxpayer may elect to pay the tax in four equal installments, in which case the first installment shall be paid on the date prescribed for the payment of the tax by the taxpayer, the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month, and the fourth installment on the fifteenth day of the ninth month, after such date. If any installment is not paid on or before the date fixed for its payment, the whole amount of the tax unpaid shall be paid upon notice and demand from the collector.

(c) **Extension of time for payment.**—At the request of the taxpayer, the Commissioner may extend the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, for a period not to exceed six months from the date prescribed for the payment of the tax or an installment thereof. In such case the amount in respect of which the extension is granted shall be paid on or before the date of the expiration of the period of the extension.

(d) **Voluntary advance payment.**—A tax imposed by this title, or any installment thereof, may be paid, at the election of the taxpayer, prior to the date prescribed for its payment.

(e) **Advance payment in case of jeopardy.**—For advance payment in case of jeopardy, see section 147.

(f) **Tax withheld at source.**—For requirement of withholding tax at the source in the case of nonresident aliens and foreign corporations, and in the case of so-called "tax-free covenant bonds," see sections 144 and 145.

(g) **Fractional parts of cent.**—In the payment of any tax under this title a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

(h) **Receipts.**—Every collector to whom any payment of any income tax is made shall upon request give to the person making such payment a full written or printed receipt, stating the amount paid and the particular account for which such payment was made; and whenever any debtor pays taxes on account of payments made or to be made by him to separate creditors the collector shall, if requested by such debtor, give a separate receipt for the tax paid on account of each creditor in such form that the debtor can conveniently produce such receipts separately to his several creditors in satisfaction of their respective demands up to the amounts stated in the receipts; and such receipt shall be sufficient evidence in favor of such debtor to justify him in withholding from his next payment to his creditor the amount therein stated; but the creditor may, upon giving to his debtor a full written receipt acknowledging the payment to him of any sum actually paid and accepting the amount of tax paid as aforesaid (specifying the same) as a further satisfaction of the debt to that amount, require the surrender to him of such collector's receipt.

ART. 431. **Date on which tax shall be paid.**—The tax, unless it is required to be withheld at the source (see sections 144 and 145) or unless it is to be paid by a nonresident alien individual (see section 218) or a foreign corporation (see section 236), is to be paid on or before the 15th day of March following the close of the calendar year, or, where the return is made on the basis of a fiscal year, on or before the 15th day of the third month following the close of such fiscal year. The tax may, at the option of the taxpayer, be paid in four equal installments instead of in a single payment, in which case the first installment is to be paid on or before the date prescribed for the payment of the tax as a single payment, the second installment on or before the 15th day of the third month, the third installment on or before the 15th day of the sixth month, and the fourth installment on or before the 15th day of the ninth month, after such date. Where the taxpayer elects to pay the tax in four installments, each of the four installments must be equal in amount, but any installment may be paid, at the election of the taxpayer, prior to the date prescribed for its payment. If an installment is not paid in full on or before the date fixed for its payment either by the Act or by the Commissioner in accordance with the terms of an extension, the whole amount of the tax unpaid shall be paid upon notice and demand from the collector.

ART. 432. **Extension of time for payment of the tax or installment thereof.**—The Commissioner, at the request of the taxpayer, may extend the time for payment of the amount determined as the tax by the taxpayer, or any part or installment thereof, for a period

not to exceed six months from the date prescribed for the payment of such amount, part, or installment. Any application for such extension should be made to the Commissioner through the collector of internal revenue for the district in which the taxpayer's return was filed, who will make proper record thereof and forward it immediately to the Commissioner. The application should set forth under oath the specific reasons for desiring an extension and should clearly indicate what hardship, if any, would result if the extension were not granted. The amount for which the extension is desired should also be stated. The Commissioner will not consider an application for an extension of time unless such application is made on or before the due date of the tax or installment thereof for which the extension is desired. As a condition to the granting of such an extension, the Commissioner may require the taxpayer to furnish a bond on Form 1130 in an amount not exceeding double the amount of the tax or installment thereof. If a bond is required it must be filed with the collector within 10 days after notification by the Commissioner that such bond is required. It shall be conditioned upon the payment of the tax and interest assessed in connection therewith in accordance with the terms of the extension granted, and shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, and shall be subject to the approval of the Commissioner. In lieu of such a bond, the taxpayer may file a bond secured by deposit of Liberty bonds or other bonds or notes of the United States equal in their total par value to an amount not exceeding double the amount of the tax or installment thereof. A request by the taxpayer for an extension of time for payment of one installment does not operate to procure an extension of time for payment of subsequent installments. Nor does an extension of time for filing a return operate to extend the time for payment of the tax or any part thereof, unless so specified in the extension. If an extension of time for payment of the tax or any installment is granted, the amount, time for payment of which is so extended, shall be paid on or before the expiration of the period of the extension, together with interest at the rate of 6 per cent per annum on such amount from the date when the payment should have been made if no extension had been granted until the expiration of the period of the extension. (See section 295.)

ART. 433. **When fractional part of cent may be disregarded.**—In the payment of taxes a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent. Fractional parts of a cent should not be disregarded in the computation of taxes.

ART. 434. **Receipts for tax payments.**—Upon request a collector will give a receipt for each tax payment. In the case of payments made by check or money order the canceled check or the money order receipt is usually a sufficient receipt. In the case of payments in cash, however, the taxpayer should in every instance require and the collector should furnish a receipt.

SEC. 57. EXAMINATION OF RETURN AND DETERMINATION OF TAX.

As soon as practicable after the return is filed the Commissioner shall examine it and shall determine the correct amount of the tax.

ART. 451.[1] **Examination of return and determination of tax by the Commissioner.**—All returns will, as soon as practicable, be given a preliminary inspection in the offices of collectors, and taxpayers will be immediately notified by the collector of changes in tax liability due to mathematical errors found in the course of such inspection. Immediately thereafter all returns, except returns made on Form 1040A and such other returns as the collector may be authorized by the Commissioner to audit, will be surveyed by revenue agents detailed from the offices of internal revenue agents in charge and classified as (1) returns properly prepared which should not require further audit, (2) returns which can be adjusted by office audit, and (3) returns which require an investigation of the books and records of the taxpayer. All such returns will be forwarded to Washington; class (1) returns for review and filing, and class (2) and (3) returns for reference to the appropriate field division for audit.

Upon the completion, under the supervision of an internal revenue agent in charge, of a field investigation or of an office audit which discloses that a deficiency apparently exists, the taxpayer will be notified of the result of the investigation or audit, and furnished with a copy of the examining agent's report or a statement of changes proposed by the auditor. Any protest which the taxpayer may desire to submit in reference to such investigation or audit must be filed within 30 days from the date of such letter of notification with the office of the field division. The internal revenue agent in charge will cause the protest of the taxpayer to be carefully heard, provided that request for a hearing is made in the protest. Any supplemental statement which the taxpayer may desire to submit in connection with a protest involving such investigation or audit must also be submitted to the office of the field division concerned. Protests or supplemental statements filed with the Income Tax Unit at Washington in connection with such investigation or audit will, before consideration thereby, be referred to the proper internal revenue agent in charge.

[1] See T. D. 4327, p. 357.

After careful consideration has been given to the taxpayer's protest, if protest is filed, or, if the period of 30 days has elapsed and no protest has been received, the internal revenue agent in charge will forward the statement of the office auditor or the report of the examining agent, together with all statements from the taxpayer and conference reports, with his recommendations to Washington for review. The case will then be reviewed in the Income Tax Unit at Washington, and, if the Unit agrees with the findings of the agent, the taxpayer will be notified by letter and afforded an opportunity for a hearing in the Unit at Washington. If upon further consideration it appears that a deficiency exists, the taxpayer will be notified by registered letter in accordance with the provisions of section 272 (a). (See article 1171.)

In case the Income Tax Unit at Washington is of the opinion that a different deficiency exists from that recommended by the internal revenue agent in charge, whether or not a protest has been filed, the taxpayer will be notified by letter that a different deficiency from that shown in the revenue agent's report appears to exist. At the same time that such letter is mailed to the taxpayer, a copy thereof will be furnished to the proper internal revenue agent in charge. Within 30 days from the date of such letter the taxpayer may file with the internal revenue agent in charge a protest against the determination of the deficiency. After consideration the internal revenue agent in charge will forward all statements by the taxpayer and any conference reports together with his recommendations to the Income Tax Unit at Washington for review. The Unit at Washington will cause the protest of the taxpayer to be carefully heard, provided that request for hearing in Washington is made in the protest filed with the internal revenue agent in charge. If upon further consideration it appears that a deficiency exists, final determination thereof will be made and the taxpayer will be notified by registered mail in accordance with the provisions of section 272 (a).

An immediate assessment without prior notice to the taxpayer may be made under section 273 (a) if it appears in any case that the collection of a deficiency would be jeopardized by delay. (See article 1181.)

In special cases where by reason of the filing of a consolidated return or for any other reason it is impracticable that the field investigation be made under the supervision of one of the internal revenue agents in charge, the Commissioner may direct that the field investigation be made by such revenue agents, special agents, or auditors as

he may specially designate. In such cases the return will be audited in the Income Tax Unit at Washington after receipt of the report of the field investigation. The taxpayer will be furnished with a copy of the report of the field investigation and notified by letter of any deficiency which appears to exist. Within 30 days from the date of the notification letter the taxpayer may file with the Income Tax Unit at Washington a protest against the determination of the deficiency. If no protest is filed within the prescribed time, final determination of the deficiency will be made and the taxpayer will be notified thereof by registered mail in accordance with the provisions of section 272 (a). If a protest is filed, it will be considered in the Income Tax Unit at Washington and hearing will be granted if requested in the protest. If it appears thereafter that a deficiency exists, final determination of the deficiency will be made, and the taxpayer will be notified thereof by registered mail in accordance with the provisions of section 272 (a).

As to those returns which are authorized to be retained in the office of the collector for audit, the taxpayer will be notified by letter upon the completion of the audit of any deficiency which appears to exist. Within 30 days from the date of the letter of notification the taxpayer may file with the collector a protest against the determination of the deficiency. If no protest is filed within the prescribed time, final determination will be made and the taxpayer will be notified by registered mail in accordance with the provisions of section 272 (a). If a protest is filed, it will be considered in the collector's office, and a hearing will be granted if requested in the protest. If the taxpayer and the collector are unable to agree respecting the amount of the deficiency, the return and the complete file pertaining thereto will be forwarded by the collector to the internal revenue agent in charge for consideration. The taxpayer will be advised by letter of the result of such consideration and may, within 30 days from the date of such letter, request a hearing before the internal revenue agent in charge. After full consideration has been given to the taxpayer's contentions, the complete file will be forwarded with the agent's recommendations to the Income Tax Unit at Washington for review in accordance with the procedure outlined herein for the review of reports of field investigations. If, upon further consideration, it appears that a deficiency exists, final determination thereof will be made, and the taxpayer will be notified by registered mail in accordance with the provisions of section 272 (a).

If in the course of any field investigation it appears that a willful attempt has been made to evade tax, the report of the investigation will be forwarded immediately to the Commissioner at Washington.

No copy of the report will be furnished to the taxpayer by the agent. After completion of the audit in the Income Tax Unit at Washington the taxpayer will be notified of such taxes and penalties as appear to be due and will be furnished with a statement showing the computation of tax and penalties. At the same time that such letter is mailed to the taxpayer, a copy thereof will be furnished to the proper internal revenue agent in charge. Within 30 days from the date of such letter the taxpayer may file with the internal revenue agent in charge a protest against the determination of the deficiency. The internal revenue agent in charge shall cause full consideration to be given to any protest against the determination of any deficiency of tax, but any hearing on a protest against a proposal to assert the ad valorem fraud penalty will be under the supervision of the General Counsel of the Bureau of Internal Revenue, whose recommendation in regard to the assertion of the ad valorem fraud penalty will be obtained prior to final determination of the deficiency. After consideration the internal revenue agent in charge will forward any statements from the taxpayer with his recommendations to the Income Tax Unit at Washington for review. The Unit at Washington will cause the protest of the taxpayer to be carefully heard, provided that request for hearing in Washington is made in the protest filed with the internal revenue agent in charge. Thereafter final determination of the deficiency and of the penalty, if any, will be made, and the taxpayer will be notified by registered mail in accordance with the provisions of section 272 (a).

If in any case (except where it appears that a willful attempt has been made to evade tax) the taxpayer acquiesces in the tentative or final determination of the deficiency, the form consenting to assessment, which will be forwarded with the letter of notification, should be executed by the taxpayer and returned in order that assessment may be made forthwith. However, in any case in which it appears that a willful attempt has been made to evade tax, the form consenting to assessment, even though executed by the taxpayer, should not to be accepted by the internal revenue agent in charge.

A letter of protest must cover all items which the taxpayer questions and may be accompanied by a statement of additional facts or by a brief, or both. It must be filed in triplicate and must contain the following information:

(*a*) The name and address of the taxpayer (in the case of an individual the residence, and in the case of a corporation the principal office or place of business);

(*b*) In the case of a corporation, the name of the State of incorporation;

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(*c*) The designation by date and symbol of the letter advising of the tentative deficiency with respect to which the protest is made;

(*d*) The designation of the year or years involved and a statement of the amount of tax in dispute for each year;

(*e*) An itemized schedule of the findings to which the taxpayer takes exception;

(*f*) A summary statement of the grounds upon which the taxpayer relies in connection with each exception; and

(*g*) In case the taxpayer desires a hearing, a statement to that effect.

Letters of protest and accompanying statements of fact, if any, must be executed by the taxpayer under oath.

The procedure outlined in this article will be followed in all cases except where it is impracticable, as, for example, cases in which the period of limitation provided in sections 275–277 is about to expire.

SEC. 58. ADDITIONS TO TAX AND PENALTIES.

(a) For additions to the tax in case of negligence or fraud in the nonpayment of tax or failure to file return therefor, see Supplement M.

(b) For criminal penalties for nonpayment of tax or failure to file return therefor, see section 146.

SEC. 59. ADMINISTRATIVE PROCEEDINGS.

For administrative proceedings in respect of the nonpayment or overpayment of a tax imposed by this title, see as follows:

(a) Supplement L, relating to assessment and collection of deficiencies.

(b) Supplement M, relating to interest and additions to tax.

(c) Supplement N, relating to claims against transferees and fiduciaries.

(d) Supplement O, relating to overpayments.

PART VI—MISCELLANEOUS PROVISIONS

SEC. 61. LAWS MADE APPLICABLE.

All administrative, special, or stamp provisions of law, including the law relating to the assessment of taxes, so far as applicable, are hereby extended to and made a part of this title.

SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title.

SEC. 63. TAXES IN LIEU OF TAXES UNDER 1926 ACT.

The taxes imposed by this title shall be in lieu of the corresponding taxes imposed by Title II of the Revenue Act of 1926, in accordance with the following table:

Taxes under this Title		Taxes under 1926 Act
Secs. 11 and 211	in lieu of	Sec. 210
Sec. 12	in lieu of	Sec. 211
Sec. 13	in lieu of	Sec. 230
Secs. 201 and 204	in lieu of	Secs. 243 and 246
Sec. 104	in lieu of	Sec. 220
Supp. E	in lieu of	Sec. 219
Sec. 101	in lieu of	Sec. 208

SEC. 64. SHORT TITLE.

This title may be cited as the "Income Tax Act of 1928."

SEC. 65. EFFECTIVE DATE OF TITLE.

This title shall take effect as of January 1, 1928, except that sections 146 and 151, and this section, shall take effect on the enactment of this Act.

DIVISION III.—SUPPLEMENTAL PROVISIONS

SUBTITLE C—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A—RATES OF TAX

[Supplementary to Subtitle B, Part I]

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) **Tax in case of capital net gain.**—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) **Tax in case of capital net loss.**—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) **Definitions.**—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition—

(A) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

(B) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(C) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain is recognized to the distributee under the provisions of section 112 (g) of this title or under the provisions of section 203 (c) of the Revenue Act of 1924 or 1926, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

(d) **Collection and payment of tax.**—The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner, at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

ART. 501.[1] **Definition and illustration of capital net gain.**—Section 101, which applies to sales and exchanges of capital assets consummated after December 31, 1921, provides that any taxpayer other than a corporation may, if he so desires, state separately in his return his net gain on sales or exchanges of capital assets, and pay on such capital net gain (as defined and limited in the section) a tax of 12½ per cent of the capital net gain in lieu of the tax he would otherwise pay on such income under sections 11, 12, 102, and 211. The tax upon his net income from other sources, termed "ordinary net income," is

[1] See T. D. 4312, p. 357.

to be computed at the rates and in the manner provided in sections 11, 12, 102, and 211. The total tax will be the sum of the tax upon the ordinary net income plus 12½ per cent of the capital net gain.

The term "capital assets" is defined to mean property held by the taxpayer for more than two years, whether or not connected with his trade or business, but not including stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. See articles 101–108 with reference to inventories. A dealer in securities is not entitled to the benefits of section 101 with reference to gain from the sale of securities. The specific property sold or exchanged must in general have been held for more than two years. However, in determining the period for which the taxpayer has held stock or securities received upon a distribution in connection with a reorganization where no gain is recognized to the distributee under the provisions of section 203 (c) of the Revenue Acts of 1924 and 1926 and section 112 (g) of the Revenue Act of 1928 (see article 576), there shall be included the period for which the taxpayer held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution. If the taxpayer has held for more than two years stock upon which a stock dividend has been declared, both the original and dividend shares are considered to be capital assets. If under the provisions of section 113 property received in an exchange has for the purpose of determining gain or loss the same basis in whole or in part in the taxpayer's hands as the property exchanged therefor, the property received in exchange is considered to be capital assets if the total period during which such property and the original property have been held is more than two years. If property is acquired from any person, and under the provisions of section 113 has the same basis in whole or in part for the purpose of determining gain or loss as it would have in the hands of the person from whom acquired, there shall be included in determining the period for which the taxpayer has held such property the period for which it was held by such person. For instance, in the case of property acquired after December 31, 1920, either by gift or by transfer in trust, the period for which the property was held by the donor shall be added to the period for which the property was held by the donee in determining whether the property was held for more than two years. (See articles 593 and 594.)

"Capital gain" is taxable gain from the sale or exchange of capital assets consummated after December 31, 1921. "Capital loss" is deductible loss resulting from the sale or exchange of capital assets. See article 591 for the basis for determining such gain or loss, and article 561 as to adjustments for improvements, depreciation, and other items. "Capital deductions" are deductions properly allocable to or chargeable against capital assets sold or exchanged during the taxable year. "Capital net gain" is the excess of the total amount of capital gain over the sum of (1) capital deductions and capital losses, and (2) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gain.

Example: A in 1928 sold an office building for $1,000,000, which he had bought in 1917 for $500,000 and on which there was depreciation aggregating $100,000, and stock in a mining company for $10,000, which he had purchased in 1921 for $20,000. Without regard to capital deductions his capital gain would be $600,000, his capital loss $10,000, and his capital net gain $590,000. If his other net income (ordinary net income) in 1928 was $50,000, he may, instead of paying normal tax and surtax on his total net income of $640,000, segregate these transactions in his return and pay a tax of 12½ per cent of his capital net gain of $590,000 plus the normal tax and surtax upon his ordinary net income of $50,000. If, on the other hand, A sustained a net loss of $50,000 in his business, had a capital gain of $600,000, and a capital loss of $10,000, his capital net gain would be $540,000. In such a case, A may, instead of paying normal tax and surtax upon his total net income of $540,000, pay a tax of 12½ per cent upon this amount.

The credit for taxes allowed by section 131 (see articles 691–698) is a credit against the total tax, however computed, but the credits allowed by section 25 are allowed "for the purpose of the normal tax only" and may not be taken against capital net gain, although they may be deducted from "ordinary net income" in computing the amount of the tax.

Example: If B, a married person, had capital net gain of $60,000 and ordinary net income of $3,000, his $3,500 personal exemption would more than offset his ordinary net income, but he may not apply any part of it to reduce his capital net gain.

Residential property held by the taxpayer for more than two years but not primarily for sale in the course of his trade or business is included within the definition of capital assets; hence, a taxpayer (other than a corporation) selling such property at a profit may elect to be taxed under section 101. A loss from the sale of such property

is a " capital loss " only to the extent that it is an allowable deduction under section 23 (e) and article 171.

Since the credit allowed an individual by section 31 in respect of earned income shall not exceed 25 per cent of his normal tax plus 25 per cent of the surtax which would be payable if his earned income constituted his entire net income, no credit under section 31 may be claimed by a taxpayer whose entire net income consists of capital net gain and who elects to be taxed under section 101.

A nonresident alien individual or a citizen entitled to the benefits of section 251 may elect to be taxed under section 101 with respect to gain from sales or exchanges of property within the United States.

ART. 502. **Returns of capital net gain.**—Segregation of transactions for the purposes of section 101 (a) is required only where the taxpayer elects to be taxed under that subdivision. When a taxpayer elects to be taxed under section 101 (a) for any taxable year, he must attach to his return of income for such year an accurate statement under oath showing all items of capital gain, capital loss, and capital deductions in such manner as will clearly show the exact amount of his capital net gain for the taxable year. Each transaction must be separately shown and the capital items with respect thereto grouped together in order that the capital gain derived or the capital loss sustained from each capital transaction will readily appear. In the case of sales or exchanges of securities or any other property, the statement must show how long the property was held by the taxpayer immediately preceding the sale or exchange.

ART. 503. **Capital net losses.**—Section 101 (b) provides for the determination of the tax in the case of any taxpayer (other than a corporation, but including the members of a partnership, an estate or trust, or the beneficiaries thereof) who in any taxable year sustains a capital net loss. A " capital net loss " is the excess of the sum of the capital losses plus the capital deductions as defined in article 501, over the total amount of capital gain as therein defined. It is to be noted that, while the tax provided in section 101 (a) in the case of a capital net gain is to be imposed at the election of the taxpayer, the limitation with respect to a capital net loss provided in section 101 (b) will be applied irrespective of the taxpayer's election.

In the case of any taxpayer, other than a corporation, who sustains a capital net loss for any taxable year, there shall be levied, collected, and paid, in lieu of the normal tax and the surtax imposed by sections 11, 12, 102, and 211, a tax determined as follows:

A partial tax will first be computed upon the basis of the ordinary net income, as defined in section 101 (c) (7) and article 501, at the rates and in the manner provided in sections 11, 12, 102, and 211, and

the total tax will be this amount minus 12½ per cent of the capital net loss, but in no case shall the tax under section 101 (b) be less than the tax computed without regard to the provisions of section 101.

SEC. 102. SALE OF MINES AND OIL OR GAS WELLS.

(a) In the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion of the tax imposed by section 12 of this title attributable to such sale shall not exceed 16 per centum of the selling price of such property or interest.

(b) For limitation to 12½ per centum rate of tax, see section 101.

ART. 511. **Surtax on sale of mineral deposits.**—Where the taxpayer by prospecting and locating claims, or by exploring and discovering undeveloped claims, has demonstrated the principal value of mines or oil or gas wells which prior to his efforts had a relatively minor value, the portion of the surtax attributable to a sale of such property or of the taxpayer's interest therein shall not exceed 16 per cent of the selling price. Exploration work alone without discovery is not sufficient to bring a case within this provision. (See article 240.) Shares of stock in a corporation owning mines or oil or gas wells do not constitute an interest in such property. To determine the application of this provision to a particular case, the taxpayer should first compute the surtax in the ordinary way upon his net income, including his net income from any such sale. The proportion of the surtax indicated by the ratio which the taxpayer's net income from the sale of the property, or his interest therein, bears to his total net income is the portion of the surtax attributable to such sale, and if it exceeds 16 per cent of the selling price of the property or interest, such portion of the surtax shall be reduced to that amount.

SEC. 103. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this title—

(1) Labor, agricultural, or horticultural organizations;

(2) Mutual savings banks not having a capital stock represented by shares;

(3) Fraternal beneficiary societies, orders, or associations, (A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system; and (B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents;

(4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

(5) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for burial purposes as a cemetery corporation and not permitted by its charter to engage in any business not necessarily incident to that purpose, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(7) Business leagues, chambers of commerce, real estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual;

(8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes;

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

(10) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 per centum or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses;

(11) Farmers' or other mutual hail, cyclone, casualty, or fire insurance companies or associations (including interinsurers and reciprocal underwriters) the income of which is used or held for the purpose of paying losses or expenses;

(12) Farmers', fruit growers', or like associations organized and operated on a cooperative basis (a) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. Exemption shall not be denied any such association because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends) is owned by producers who market their products or purchase their supplies and equipment through the association; nor shall exemption be denied any such association because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose. Such an association may market the products of nonmembers in an amount the value of which does not exceed the value of the products marketed for members, and may purchase supplies and equipment for nonmembers in an amount the value of which does not exceed the value of the supplies and equipment purchased for members, provided the value of the purchases made for persons who are neither members nor producers does not exceed 15 per centum of the value of all its purchases;

(13) Corporations organized by an association exempt under the provisions of paragraph (12), or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per centum per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, upon dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose;

(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this title;

(15) Federal land banks, national farm-loan associations, and Federal intermediate credit banks, as provided in the Federal Farm Loan Act, as amended;

(16) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents, if (A) no part of their net earnings inures (other than through such payments) to the benefit of any private shareholder or individual, and (B) 85 per centum or more of the income consists of amounts collected from members for the sole purpose of making such payments and meeting expenses;

(17) Teachers' retirement fund associations of a purely local character, if (A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and (B) the income consists solely of amounts received from public taxation, amounts received from assessments upon the teaching salaries of members, and income in respect of investments,

ART. 521. **Proof of exemption.**—In order to establish its exemption and thus be relieved of the duty of filing returns of income and paying the tax, it is necessary that every organization claiming exemption file an affidavit with the collector of the district in which it is located, showing the character of the organization, the purpose for which it was organized, its actual activities, the sources of its income and its disposition, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such affidavit should be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement, showing the assets, liabilities, receipts, and disbursements of the organization.

In the case of the particular classes of organizations listed below, the following additional information should be embodied in or attached to, and made a part of, the affidavit referred to above:

(1) Fraternal beneficiary societies, orders, or associations: (*a*) The number of subordinate lodges in active operation, (*b*) whether periodical meetings are actually held;

(2) Building and loan associations and cooperative banks: These associations and banks shall submit the information required by Questionnaire, Form 1027, copies of which may be obtained from any collector;

(3) Educational organizations: Whether any of the shareholders are paid by the organization, and if so, the reason for each such payment and the amount thereof;

(4) Hospitals: Whether nonpay patients are accepted;

(5) Business leagues: (*a*) A statement of the services performed for members, (*b*) a statement of the services performed for nonmembers;

(6) Clubs: The income received from the use of the facilities by the general public;

(7) Benevolent life insurance associations: (*a*) The number of counties in which the association accepts risks, (*b*) copies of the policies or certificates of membership;

(8) Mutual insurance companies: Copies of the policies or certificates of membership;

(9) Farmers' cooperative associations: These associations shall submit the information required by Questionnaire, Form 1028, copies of which may be obtained from any collector;

(10) Holding companies: (*a*) The name of the organization for which it holds title, (*b*) the information necessary to establish the exemption, under section 103, of the organization for which title is held.

The collector, upon receipt of the affidavit and other papers, will forward them to the Commissioner for decision as to whether the organization is exempt.

When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. Collectors will keep a list of all exempt corporations, to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

ART. 522. **Labor, agricultural, and horticultural organizations.**—The organizations contemplated by section 103 (1) as entitled to exemption from income taxation are those which—

(1) Have no net income inuring to the benefit of any member;

(2) Are educational or instructive in character; and

(3) Have as their objects the betterment of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.

Organizations such as county fairs and like associations of a quasi-public character, which are designed to encourage the development of better agricultural and horticultural products through a system of awards, and whose income from gate receipts, entry fees, and donations is used exclusively to meet the necessary expenses of upkeep and operation, are thus exempt. On the other hand, associations which have for their purpose, for example, the holding of periodical race meets, the profits from which may inure to the benefit of their shareholders, are not exempt. Similarly, corporations engaged in growing agricultural or horticultural products for profit are not exempt from tax.

ART. 523. **Mutual savings banks.**—In order that a corporation may be entitled to exemption as a mutual savings bank, it must appear that it is an organization—

(1) Which has no capital stock represented by shares, and

(2) Whose earnings, less only the expenses of operation, are distributable wholly among the depositors.

If it appears that the organization has shareholders who participate in the profits, the organization will not be exempt from income taxation under the Act.

ART. 524. **Fraternal beneficiary societies.**—A fraternal beneficiary society is exempt from tax only if operated under the "lodge system," or for the exclusive benefit of the members of a society so operating. "Operating under the lodge system" means carrying on its activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. In order to be exempt it is also necessary that the society have an established system for the payment to its members or their dependents of life, sick, accident, or other benefits.

ART. 525. **Building and loan associations and cooperative banks.**—A building and loan association organized pursuant to and operating in accordance with the laws of the United States or a State or Territory thereof, substantially all the business of which association is confined to making loans to members, is entitled to exemption.

Cooperative banks without capital stock organized and operated for mutual purposes and without profit are exempt. Credit unions such as those organized under the laws of Massachusetts, being in substance and in fact the same as cooperative banks, are likewise exempt from tax.

ART. 526. **Cemetery companies.**—A cemetery company may be entitled to exemption—

(1) If it is owned by and operated exclusively for the benefit of its lot owners, or

(2) If it is not operated for profit.

Any cemetery corporation chartered solely for burial purposes and not permitted by its charter to engage in any business not necessarily incident to that purpose, is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual. A cemetery company which fulfills the other requirements of the Act may be exempt, even though it issues preferred stock entitling the holders to dividends at a fixed rate, provided that its articles of incorporation require—

(1) That the preferred stock shall be retired at par as soon as sufficient funds are realized from sales, and

(2) That all funds not required for the payment of dividends upon or for the retirement of preferred stock shall be used by the company for the care and improvement of the cemetery property.

ART. 527. **Religious, charitable, scientific, literary, and educational organizations and community chests.**—In order to be exempt under section 103 (6), the organization must meet two tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes; and

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals.

Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

An association whose sole purpose is the instruction of the public, or an association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community may be exempt as an educational corporation, even though such an association has incidental amusement features. Associations formed to disseminate controversial or partisan propaganda are not educational within the meaning of the Act.

Since a corporation to be exempt under section 103 (6) must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and which also manufactures and sells articles to the public for profit, is not exempt even though its property is held in common and its profits do not inure to the benefit of individual members of the organization.

The words "private shareholder or individual" in section 103 refer to individuals having a personal and private interest in the activities of the corporation.

ART. 528. **Business leagues, chambers of commerce, real estate boards, and boards of trade.**—A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus its activities should be directed to the improvement of business conditions or to the promotion of the general objects of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self-sustaining, is not a business league. An association engaged in furnishing information to prospective investors, to enable them to make sound investments, is not a business league, since its activities do not further any common business interest, even though all of its income is devoted to the purpose

stated. A stock exchange is not a business league, a chamber of commerce, or a board of trade within the meaning of the law and is not exempt from tax.

ART. 529. **Civic leagues and local associations of employees.**—Civic leagues entitled to exemption under section 103 (8) comprise those not organized for profit but operated exclusively for purposes beneficial to the community as a whole, and, in general, include organizations engaged in promoting the welfare of mankind, other than organizations comprehended within section 103 (6). Certain local associations of employees are also expressly entitled to exemption under section 103 (8). The Act prescribes as conditions to exemption (1) that the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, and (2) that the net earnings of the association be devoted exclusively to charitable, educational, or recreational purposes. See article 527 with reference to the meaning of "charitable" and "educational" in the Act.

ART. 530. **Social clubs.**—The exemption granted by section 103 (9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and assessments. If a club, by reason of the comprehensive powers granted in its charter, engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes, and any profit realized from such activities is subject to tax.

ART. 531. **Local benevolent life insurance associations, mutual irrigation and telephone companies, and like organizations.**—It is a prerequisite to exemption under section 103 (10) that at least 85 per cent of the income of the organization shall consist of amounts collected from members for the sole purpose of meeting losses and expenses. If an organization issues policies for stipulated cash premiums, or if it requires advance deposits to cover the cost of the insurance and maintains investments from which more than 15 per cent of its income is derived, it is not entitled to exemption. On the other hand, an organization may be entitled to exemption, although it makes advance assessments for the sole purpose of meeting future losses and expenses, provided that the balance of such assessments remaining on hand at the end of the year is retained to meet losses and expenses or is returned to members.

The phrase "of a purely local character" applies to benevolent life insurance associations, and not to the other organizations specified in section 103 (10). It applies, however, to any organization seeking exemption on the ground that it is an organization similar

to a benevolent life insurance association. An organization of a purely local character is one whose business activities are confined to a particular community, place, or district, irrespective, however, of political subdivisions.

ART. 532. **Farmers' cooperative marketing and purchasing associations, and corporations organized to finance crop operations.**—(*a*) Cooperative associations engaged in the marketing of farm products for farmers, fruit growers, live-stock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the products furnished by them, are exempt from income tax and shall not be required to file returns. Thus cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the Act and is not exempt. An association which has capital stock will not for such reason be denied exemption, (1) if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 per cent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and (2) if substantially all of such stock (with the exception noted below) is owned by producers who market their products or purchase their supplies and equipment through the association. Any ownership of stock by others than such actual producers must be satisfactorily explained in the association's application for exemption. The association will be required to show that the ownership of its capital stock has been restricted as far as possible to such actual producers. If by statutory requirement all officers of an association must be shareholders, the ownership of a share of stock by a nonproducer to qualify him as an officer will not destroy the association's exemption. Likewise, if a shareholder for any reason ceases to be a producer and the association is unable, because of a constitutional inhibition or other reason beyond the control of the association, to purchase or retire the stock of such nonproducer, the fact that under such circumstances a small amount of the outstanding capital stock is owned by shareholders who are no longer producers will not destroy the exemption. The restriction placed on the ownership of capital stock of an exempt cooperative association shall not apply to nonvoting preferred stock, provided the owners of such stock are not entitled or permitted to participate,

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directly or indirectly, in the profits of the association, upon dissolution or otherwise, beyond the fixed dividends. The accumulation and maintenance of a reserve required by State statute, or the accumulation and maintenance of a reasonable reserve or surplus for any necessary purpose, such as to provide for the erection of buildings and facilities required in business or for the purchase and installment of machinery and equipment or to retire indebtedness incurred for such purposes, will not destroy the exemption. An association will not be denied exemption because it markets the products of nonmembers, provided the value of the products marketed for nonmembers does not exceed the value of the products marketed for members.

(*b*) Cooperative associations engaged in the purchasing of supplies and equipment for farmers, fruit growers, live-stock growers, dairymen, etc., and turning over such supplies and equipment to them at actual cost, plus the necessary operating expenses, are exempt. The provisions of paragraph (*a*) relating to a reserve or surplus and to capital stock shall apply to associations coming under this paragraph. An association which purchases supplies and equipment for nonmembers will not for such reason be denied exemption, provided the value of the purchases for nonmembers does not exceed the value of the supplies and equipment purchased for members, and provided the value of the purchases made for nonmembers who are not producers does not exceed 15 per cent of the value of all its purchases.

In order to be exempt under either (*a*) or (*b*) an association must establish that it has no net income for its own account other than that reflected in a reserve or surplus authorized in paragraph (*a*). An association engaged both in marketing farm products and in purchasing supplies and equipment is exempt if as to each of its functions it meets the requirements of the Act.

(*c*) Corporations organized by farmers' cooperative marketing or purchasing associations, or the members thereof, for the purpose of financing the ordinary crop operations of such members or other producers are also exempt, provided the marketing or purchasing association is exempt under section 103 (12) (see paragraphs (*a*) and (*b*) of this article), and the financing corporation is operated in conjunction with the marketing or purchasing association. The provisions of paragraph (*a*) relating to a reserve or surplus and to capital stock shall also apply to corporations coming under this paragraph.

SEC. 104. ACCUMULATION OF SURPLUS TO EVADE SURTAXES.

(a) If any corporation, however created or organized, is formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders through the medium of permitting its

gains and profits to accumulate instead of being divided or distributed, there shall be levied, collected, and paid for each taxable year upon the net income of such corporation a tax equal to 50 per centum of the amount thereof, which shall be in addition to the tax imposed by section 13 and shall be computed, collected, and paid upon the same basis and in the same manner and subject to the same provisions of law, including penalties, as that tax.

(b) The fact that any corporation is a mere holding or investment company, or that the gains or profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a purpose to escape the surtax.

(c) As used in this section the term "net income" means the net income as defined in section 21, increased by the sum of the amount of the dividend deduction allowed under section 23 (p) and the amount of the interest on obligations of the United States issued after September 1, 1917, which would be subject to tax in whole or in part in the hands of an individual owner.

(d) The tax imposed by this section shall not apply if all the shareholders of the corporation include (at the time of filing their returns) in their gross income their entire distributive shares, whether distributed or not, of the net income of the corporation for such year. Any amount so included in the gross income of a shareholder shall be treated as a dividend received. Any subsequent distribution made by the corporation out of the earnings or profits for such taxable year shall, if distributed to any shareholder who has so included in his gross income his distributive share, be exempt from tax in the amount of the share so included.

ART. 541. **Taxation of corporation utilized for evasion of surtax.**—Section 104 is designed to discourage the formation or use of a corporation for the purpose of preventing the imposition of surtaxes upon its shareholders, through the device of permitting its gains and profits to accumulate instead of being distributed. If a domestic or foreign corporation is so formed or availed of, it is subject to a tax at the rate of 50 per cent upon its net income in addition to the tax imposed by section 13. However, the additional tax at the rate of 50 per cent does not apply for 1928 or any subsequent taxable year if all the shareholders of the corporation include (at the time of filing their returns) in their gross income their entire distributive share, whether distributed or not, of the net income of the corporation for such year or years. Any amount so included in the gross income of a shareholder shall be treated as a dividend received, and any subsequent distribution made by the corporation out of the earnings or profits for such taxable years shall, if distributed to any shareholder who has so included in his gross income his distributive share, be exempt from tax in the amount of the share so included.

ART. 542. **Purpose to escape surtax.**—Prima facie evidence of a purpose to escape the surtax exists where a corporation is a mere investment company, where a corporation has practically no business except holding stocks, securities, or other property and collecting the income therefrom or investing therein, or where a corporation other than a mere holding or investment company permits its gains and profits to accumulate beyond the reasonable needs of the business. The statutory presumption that a mere holding or investment company is subject to the additional tax imposed by section 104 may be overcome if the corporation can show, either by reason of the fact that it distributed a large portion of its earnings for the year in question, or that its stock was held not by the members of a family or of a small group but by a large number of persons and in comparatively small blocks, or by other evidence, that it was not availed of for the purpose of preventing the imposition of the surtax upon its shareholders.

The business of a corporation is not merely that which it has previously carried on, but includes in general any line of business which it may legitimately undertake. However, a radical change of business when a considerable surplus has been accumulated may afford evidence of a purpose to escape the surtax. When one corporation owns the stock of another corporation in the same or a related line of business and in effect operates the other corporation, the business of the latter may be considered in substance the business of the first corporation. Gains and profits of the first corporation put into the second through the purchase of stock or otherwise may therefore, if a subsidiary relationship is established, constitute employment of the income in its own business. To establish that the business of one corporation can be regarded as including the business of another it is ordinarily essential that the first corporation own substantially all of the stock of the second. Investment by a corporation of its income in stock and securities of another corporation is not without anything further to be regarded as employment of the income in its business.

ART. 543. **Unreasonable accumulation of profits.**—An accumulation of gains and profits is unreasonable if it is not required for the purposes of the business, considering all the circumstances of the case. It is not intended, however, to prevent reasonable accumulations of surplus for the needs of the business. No attempt can be made to enumerate all the ways in which gains and profits of a corporation may be accumulated for the reasonable needs of the business. Distributions made by a corporation shortly after the close of its taxable year shall be taken into consideration in determining the reasonableness of the amount of earnings and profits of the corporation retained by it for such year. Undistributed income is properly accumulated if invested in increased inventories or additions to plant reasonably needed by the business. It is properly accumulated if retained for working capital required by the business or in accordance with contract obligations placed to the credit of a sinking fund for the purpose of retiring bonds issued by the corporation. In the case of a banking institution the business of which is to receive and loan money, using capital, surplus, and deposits for that purpose, undistributed income actually represented by loans or reasonably retained for future loans is not accumulated beyond the reasonable needs of the business. The nature of the investment of gains and profits is immaterial if they are not in fact needed in the business. It is an unreasonable accumulation of gains and profits by corporations with the purpose of enabling their shareholders to escape surtaxes on such gains and profits which subjects such corporations to the additional tax imposed by section 104. Among other things, the financial condition of the corporation at the close of the taxable year and the manner in which its funds are invested at that date, determine the reasonableness of the accumulations.

For the purpose of section 104 the term "net income" means the net income of the corporation as defined in section 21 increased by the sum of (1) the amount received as dividends and allowed as a deduction by section 23 (p), plus (2) the amount of interest on obligations of the United States issued after September 1, 1917, which would be subject to tax in whole or in part in the hands of an individual owner. The Commissioner, or any collector upon direction from the Commissioner, may require any corporation to furnish a statement of its accumulated gains and profits, the name and address of, and number of shares held by, each of its shareholders, and the amounts that would be payable to each, if the income of the corporation were distributed. (See section 149 (c).)

SEC. 105. TAXABLE PERIOD EMBRACING YEARS WITH DIFFERENT LAWS.

If it is necessary to compute the tax for a period beginning in one calendar year (hereinafter in this section called "first calendar year") and ending in the following calendar year (hereinafter in this section called "second calendar year") and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then the tax under this title for the period ending during the second calendar year shall be the sum of: (1) the same proportion of a tax for the entire period, determined under the law applicable to the first calendar year and at the rates for such year, which the portion of such period falling within the first calendar year is of the entire period;

and (2) the same proportion of a tax for the entire period, determined under the law applicable to the second calendar year and at the rates for such year, which the portion of such period falling within the second calendar year is of the entire period.

ART. 551. **Fiscal years ending in 1928.**—The tax for a period beginning in 1927 and ending in 1928 is the sum of the following:

(*a*) The tax attributable to the calendar year 1927, found by computing the tax upon the income of the taxpayer for the fiscal year under the provisions of the Revenue Act of 1926, and by taking the proportion of such tax which the portion of the period falling within the calendar year 1927 is of the entire period;

(*b*) The tax attributable to the calendar year 1928, found by computing the tax upon the income of the taxpayer for the fiscal year under the provisions of the Revenue Act of 1928, and by taking the proportion of such tax which the portion of the period falling within the calendar year 1928 is of the entire period.

If the fiscal year of a partnership began in the calendar year 1927 and ended in the calendar year 1928, the taxes of the partners shall be computed as provided in article 903.

SUPPLEMENT B—COMPUTATION OF NET INCOME

[Supplementary to Subtitle B, Part II]

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) Computation of gain or loss.—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

(b) Adjustment of basis.—In computing the amount of gain or loss under subsection (a)—

(1) Proper adjustment shall be made for any expenditure, receipt, loss, or other item, properly chargeable to capital account, and

(2) The basis shall be diminished by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property been allowable in respect of such property under this Act or prior income tax laws; but in no case shall the amount of the diminution in respect of depletion exceed a depletion deduction computed without reference to discovery value under section 114 (b) (2) or to percentage depletion under section 114 (b) (3). In addition, if the property was acquired before March 1, 1913, the basis (if other than the fair market value as of March 1, 1913) shall be diminished in the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before such date, and

(3) In the case of stock the basis shall be diminished by the amount of distributions previously made in respect of such stock, to the extent provided under the law applicable to the year in which the distribution was made.

(c) Amount realized.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) Recognition of gain or loss.—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

(e) Installment sales.—Nothing in this section shall be construed to prevent (in the case of property sold under contract providing for payment in installments) the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received.

ART. 561.[1] **Determination of the amount of gain or loss.**—Section 111 sets forth the rules for the determination of the amount of gain or loss from the sale or other disposition of property. In general, the gain from the sale or other disposition of property is the excess of the amount realized therefrom over the cost or other basis provided in section 113 and articles 591–604, and the loss is the excess of such cost or other basis over the amount realized. Whether gain or loss from a sale or exchange shall be recognized, and if so, the extent to which it is to be recognized for the purpose of income taxation, must be determined under the provisions of section 112 and articles 571–580.

The amount realized from the sale or other disposition of property is the sum of any money received plus the fair market value of the property (other than money) received. The fair market value of property is a question of fact, but only in rare and extraordinary cases does property have no fair market value. In computing the amount of gain or loss, however, the cost or other basis of the property shall be properly adjusted for any expenditure, receipt, loss, or other item properly chargeable to capital account, including the cost of improvements and betterments made to the property since the basic date and carrying charges, such as taxes on unproductive property. Where the taxpayer has elected to deduct carrying charges in computing net income, or used such charges in determining his liability for filing returns of income for prior years, the cost or other basis may not be increased by such items in computing the gain or loss from the subsequent sale of the property. The cost or other basis of the property must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion which have since the acquisition of the property

[1] See T. D. 4321, p. 358.

been allowable in respect of such property, whether or not such deductions were claimed by the taxpayer or formally allowed. Adjustment to the cost or other basis on account of such allowable deductions as distinguished from the deductions actually taken in prior years, will be made only upon the basis of explicit and convincing evidence (and calculations based upon a theoretical formula are not such evidence) that the deductions taken were insufficient or excessive, as the case may be, due regard being given to the expenditures made by the taxpayer to maintain the effective usefulness of the property. In no case shall the amount of the diminution in respect of depletion exceed a depletion deduction computed without reference to discovery value in the case of mines, or without reference to the allowance for depletion provided by section 114 (b) (3) in the case of oil and gas wells. (See articles 241 and 611.) In addition, if the property was acquired before March 1, 1913, the basis (if other than the fair market value as of March 1, 1913) must be diminished by the amount of exhaustion, wear and tear, obsolescence, and depletion actually sustained before that date. In the case of stock the basis must be diminished by the amount of distributions previously made in respect of such stock, to the extent provided under the law applicable to the year in which the distribution was made.

Example (1): A purchased property in 1923 for $10,000. He subsequently expended $6,000 for improvements, which was not deductible as a business expense. The depreciation allowable with respect to the property for the period held amounted to $1,000. If A sells the property in 1928 for $20,000, the amount of his gain will be $5,000.

Example (2): A purchased property in 1923 for $10,000. The depreciation allowable with respect to the property for the period held amounted to $1,000. If A sells the property in 1928 for $8,000, the amount of his loss will be $1,000.

In the case of property sold on the installment plan, section 111 and this article shall not be construed as preventing the taxation of that portion of any installment payment representing gain or profit in the year in which such payment is received. (See section 44 and articles 351–355.)

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) General rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges solely in kind.—

(1) PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT.—No gain or loss shall be recognized if property held for productive use in

trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(2) STOCK FOR STOCK OF SAME CORPORATION.—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) SAME—GAIN OF CORPORATION.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(5) TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

(c) Gain from exchanges not solely in kind.—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) Same—gain of corporation.—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock

or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(e) Loss from exchanges not solely in kind.—If an exchange would be within the provisions of subsection (b) (1) to (5), inclusive, of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(f) Involuntary conversions.—If property (as a result of its destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation, or the threat or imminence thereof) is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted, or into money which is forthwith in good faith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended in the acquisition of other property similar or related in service or use to the property so converted, or in the acquisition of control of a corporation owning such other property, or in the establishment of a replacement fund, no gain or loss shall be recognized. If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended.

(g) Distribution of stock on reorganization.—If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

(h) Same—effect on future distributions.—The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, shall not be considered a distribution of earnings or profits within the meaning of section 115 (b) for the purpose of determining the taxability of subsequent distributions by the corporation.

(i) Definition of reorganization.—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) Definition of control.—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

ART. 571. **Recognition of gain or loss.**—In the case of a sale or exchange, the extent to which the amount of gain or loss determined under section 111 shall be recognized, is governed by the provisions of section 112. Section 112 provides that the entire amount of the gain or loss upon any sale or exchange of property shall be recognized, with specified exceptions therein set forth, which are discussed in articles 572–580. Unless the sale or exchange falls within the provisions of these articles the entire amount of the gain or loss thereon must be calculated and reported.

ART. 572. **Exchanges of property.**—In the following cases no gain or loss is recognized:

(*a*) If property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment. The words "like kind" have reference to the nature or character of the property and not its grade or quality. Therefore, under this paragraph no gain or loss is realized by one other than a dealer from the exchange of real estate for other real estate. One kind or class of property may not, under this paragraph, be exchanged for property of a different kind or class, as real estate for personal property. However, a leasehold of a fee with 30 years or more to run will be considered property of like kind to real estate. The fact that any real estate involved in an exchange is improved or unimproved makes no difference, for such fact relates only to the grade or quality of the property and not to its kind or class. Unproductive real estate held by one other than

a dealer for future use or future realization of the increment in value is held for investment and not primarily for sale.

(*b*) If common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(*c*) If property, real, personal, or mixed, is transferred to a corporation (1) by one person solely in exchange for stock or securities in such corporation, and immediately after the exchange such person is in control of the corporation, or (2) by two or more persons solely in exchange for stock or securities in such corporation, and if immediately after the exchange such persons are in control of the corporation, and the amount of stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. See section 112 (j) and article 577 for definition of "control."

Example: A owns a patent right worth $25,000 and B a manufacturing plant worth $75,000. A and B organize the X Corporation with a capital stock of $100,000. A transfers his patent right to the X Corporation for $25,000 of its stock; B transfers his plant to the X Corporation for $75,000 of its stock. No gain or loss is recognized from this transaction.

ART. 573. **Exchanges of property for other property and money.**—If an exchange would fall within the provisions of article 572 but for the fact that the property received in exchange consists not only of property permitted by that article to be received without the recognition of gain, but also of other property or money, the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of the money and the fair market value of the other property. No loss from such an exchange will be recognized. (See section 112 (e).)

Example: A in 1928 exchanged real estate which he had purchased in 1917 for $5,000 for other real estate having a fair market value of $6,000 and $2,000 in cash. The gain from the transaction, that is, $3,000, is recognized only to the extent of $2,000, the amount which was received in cash. A's taxable income from the exchange is, therefore, $2,000. See article 597 for the basis for determining gain or loss from a subsequent sale.

ART. 574. **Exchanges in connection with corporate reorganizations.**—The Act provides that no gain or loss shall be recognized if, in pursuance of a plan of reorganization, stock or securities in a corporation a party to a reorganization are exchanged solely for stock or securities in such corporation or in another corporation a party to the

reorganization, or if, in pursuance of a reorganization plan, a corporation a party to a reorganization exchanges property solely for stock or securities in another corporation a party to the reorganization. If two or more corporations reorganize, for example, by—

(1) The merger of the X Corporation into the Y Corporation,

(2) The consolidation of the X Corporation and the Z Corporation into the Y Corporation, a new corporation,

(3) The acquisition by the Y Corporation of a majority of the voting stock and a majority of the total number of shares of all other classes of stock of the X Corporation or of substantially all of the properties of the X Corporation, or

(4) The transfer by the X Corporation of a part of its assets to the Y Corporation where immediately after the transfer the X Corporation or its shareholders or both are in control of the Y Corporation—

then no taxable income is received from the transaction by the X Corporation or the Z Corporation if the sole consideration received by the corporations is stock or securities of the Y Corporation; and no taxable income is received from the transaction by the shareholders of either the X Corporation or the Z Corporation if the sole consideration received by the shareholders is stock or securities of the Y Corporation.

If a reorganization is accomplished by the transfer by the X Corporation of a part of its assets to the Y Corporation in exchange for the stock of the Y Corporation and the X Corporation distributes to its shareholders the stock of the Y Corporation, no gain to the shareholders from the receipt of such stock is recognized. (See article 576.)

Provision is made in the Act for cases in which gain to the shareholders is recognized, in connection with a reorganization, through the receipt of cash or property other than the stock of a corporation a party to the reorganization. (See article 575.)

Records in substantial form, showing the basis of the stock or property exchanged and the amount of property or money received in exchange, must be kept to enable the determination of gain or loss from a subsequent disposition of the stock or property received in exchange.

ART. 575. **Exchanges in reorganizations for stock or securities and other property or money.**—If stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged for stock or securities in such corporation or in another corporation a party to the reorganization and other property or money, the gain, if any, to the recipient will be recog-

nized in an amount not in excess of the sum of the money and the fair market value of the other property. No loss from such an exchange will be recognized. (See section 112 (e).) If a distribution of property or money in the course of a reorganization is otherwise within the provisions of this paragraph, but has the effect of the distribution of a taxable dividend, there shall be taxed to each distributee (1) as a dividend, such an amount of the gain recognized under this paragraph as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and (2) as a gain from the exchange of property, the remainder of the gain recognized under this paragraph.

Example (1): A, in connection with a reorganization, exchanges in 1928 a share of stock in the X Corporation, purchased in 1921 for $100, for (*a*) a share of stock in the Y Corporation, a party to the reorganization, which has a fair market value of $90, and (*b*) $20 cash. The gain from the transaction, $10, is recognized and taxed to A. See article 597 for the basis for determining gain or loss from a subsequent sale.

Example (2): The X Corporation has a capital of $100,000 and earnings and profits of $50,000 accumulated since February 28, 1913. The X Corporation in 1928 transfers all its assets to the Y Corporation in exchange for the issuance of all of the stock of the Y Corporation and the payment of $50,000 in cash to the shareholders of the X Corporation. A, who owns one share of stock in the X Corporation, for which he paid $100, receives a share of stock in the Y Corporation worth $100 and in addition $50 in cash. A will be liable to the surtax on $50.

If, in pursuance of a plan of reorganization, property is exchanged by a corporation a party to a reorganization for stock or securities in another corporation a party to the reorganization and other property or money, then, if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property so received which is not distributed. In either case no loss from the exchange will be recognized. (See section 112 (e).)

ART. 576. **Receipt of stock or securities in reorganization.**—If, without any surrender of his stock or securities, a shareholder in a corporation a party to a reorganization receives in pursuance of the plan of reorganization stock or securities in such corporation or in another corporation a party to the reorganization, no gain to the shareholder will be recognized.

ART. 577. **Definitions.**—The term "reorganization," as used in sections 112, 113, and 115 means—

(1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),

(2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,

(3) A recapitalization, or

(4) A mere change in identity, form, or place of organization, however effected.

The term "a party to a reorganization" as used in sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.

A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 112, when owning—

(1) At least 80 per cent of the voting stock, and

(2) At least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

ART. 578. **Source of distribution of stock or securities.**—The general rule, provided in section 115 (b), that every distribution is made

out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to a distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or of stock or securities in a corporation a party to the reorganization. Such a distribution will not be considered a distribution of earnings or profits in determining the amount of earnings and profits accumulated since February 28, 1913, which are available for distribution and which under section 115 (b) must be distributed before earnings and profits accumulated before March 1, 1913, may be distributed exempt from tax.

Example: The X Corporation has a capital of $100,000, earnings and profits accumulated prior to March 1, 1913, of $25,000, and earnings and profits of $50,000 accumulated after February 28, 1913. It causes the organization of the Y Corporation, to which it transfers $50,000 of its assets in exchange for all of the stock of the Y Corporation. It then distributes the stock of the Y Corporation as a dividend to its shareholders. No gain to the shareholders from the receipt of this stock will be recognized under the provisions of section 112 (g) and article 576, nor will the distribution be considered a distribution of earnings or profits in determining the amount of earnings and profits accumulated since February 28, 1913, on hand for subsequent distribution as a dividend.

The provisions of this article apply to the case in which the X Corporation distributes the stock of the Y Corporation as a dividend, the case in which the X Corporation distributes the stock of the Y Corporation in retirement of a portion of the stock of the X Corporation, and the case in which the Y Corporation issues its stock direct to the shareholders of the X Corporation.

ART. 579. **Involuntary conversion of property.**—Section 112 (f) deals with cases in which property is compulsorily or involuntarily converted into similar property, or into money, as a result of fire, shipwreck, theft, condemnation, or similar causes enumerated in the Act. If the property so destroyed, stolen, seized, or condemned is replaced in kind by similar property or property related in service or use, no gain or loss is recognized. If, however, the original property is compulsorily or involuntarily converted into money, gain or loss will be recognized unless the money is forthwith, under regulations prescribed by the Commissioner with the approval of the Secretary, expended—

(1) In the acquisition of other property similar or related in service or use to the property so converted,

(2) In the acquisition of control of a corporation owning such other property, or

(3) In the establishment of a replacement fund.

If any part of the money is not so expended, the gain, if any, shall be recognized, but in an amount not in excess of the money which is not so expended. See article 601 for the basis for determining gain or loss from the sale or other disposition of the property so acquired.

ART. 580. **Replacement funds.**—In any case where the taxpayer elects to replace or restore the converted property but it is not practicable to do so immediately, he may obtain permission to establish a replacement fund in his accounts in which part or all of the compensation so received shall be held, without deduction for the payment of any mortgage. In such a case the taxpayer should make application to the Commissioner on Form 1114 for permission to establish such a replacement fund, and in his application should recite all the facts relating to the transaction and declare that he will proceed as expeditiously as possible to replace or restore such property. The taxpayer will be required to furnish a bond with such surety as the Commissioner may require in an amount not in excess of double the estimated additional income taxes which would be payable if no replacement fund were established. (See section 1126 of the Revenue Act of 1926.) The estimated additional taxes, for the amount of which the claimant is required to furnish security, should be computed at the rates at which the claimant would have been obliged to pay, taking into consideration the remainder of his net income and resolving against him all matters in dispute affecting the amount of the tax. Only surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds will be approved as sureties. The application should be executed in triplicate, so that the Commissioner, the applicant, and the surety or depositary may each have a copy.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) **Property acquired after February 28, 1913.**—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

(1) INVENTORY VALUE.—If the property should have been included in the last inventory, the basis shall be the last inventory value thereof;

(2) GIFT AFTER DECEMBER 31, 1920.—If the property was acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the facts neces-

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sary to determine such basis are unknown to the donee, the Commissioner shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of such property as found by the Commissioner as of the date or approximate date at which, according to the best information that the Commissioner is able to obtain, such property was acquired by such donor or last preceding owner;

(3) TRANSFER IN TRUST AFTER DECEMBER 31, 1920.—If the property was acquired after December 31, 1920, by a transfer in trust (other than by a transfer in trust by a bequest or devise) the basis shall be the same as it would be in the hands of the grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made;

(4) GIFT OR TRANSFER IN TRUST BEFORE JANUARY 1, 1921.—If the property was acquired by gift or transfer in trust on or before December 31, 1920, the basis shall be the fair market value of such property at the time of such acquisition. The provisions of this paragraph shall apply to the acquisition of such property interests as are specified in section 402 (e) of the Revenue Act of 1921, or in section 302 (f) of the Revenue Act of 1924 or the Revenue Act of 1926 (relating to property passing under power of appointment) regardless of the time of acquisition;

(5) PROPERTY TRANSMITTED AT DEATH.—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death;

(6) TAX-FREE EXCHANGES GENERALLY.—If the property was acquired upon an exchange described in section 112 (b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. If the property so acquired consisted in part

of the type of property permitted by section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in this paragraph shall be allocated between the properties (other than money) received, and for the purpose of the allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange. This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it;

(7) TRANSFERS TO CORPORATION WHERE CONTROL OF PROPERTY REMAINS IN SAME PERSONS.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer;

(8) SAME—CORPORATION CONTROLLED BY TRANSFEROR.—If the property was acquired after December 31, 1920, by a corporation by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made;

(9) TAX-FREE DISTRIBUTIONS.—If the property consists of stock or securities distributed after December 31, 1923, to a taxpayer in connection with a transaction described in section 112 (g), the basis in the case of the stock in respect of which the distribution was made shall be apportioned, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, between such stock and the stock or securities distributed;

(10) INVOLUNTARY CONVERSION.—If the property was acquired as the result of a compulsory or involuntary conversion described in section 112 (f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon

such conversion under the law applicable to the year in which such conversion was made;

(11) WASH SALES OF STOCK.—If substantially identical property was acquired after December 31, 1920, in place of stock or securities which were sold or disposed of and in respect of which loss was not allowed as a deduction under section 118 of this Act, or under section 214 (a) (5) or 234 (a) (4) of the Revenue Act of 1921, the Revenue Act of 1924, or the Revenue Act of 1926, the basis in the case of the property so acquired shall be the basis in the case of the stock or securities so sold or disposed of, except that if the repurchase price was in excess of the sale price such basis shall be increased in the amount of the difference, or if the repurchase price was less than the sale price such basis shall be decreased in the amount of the difference;

(12) PROPERTY ACQUIRED DURING AFFILIATION.—In the case of property acquired by a corporation, during a period of affiliation, from a corporation with which it was affiliated, the basis of such property, after such period of affiliation, shall be determined, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, without regard to inter-company transactions in respect of which gain or loss was not recognized. For the purposes of this paragraph, the term "period of affiliation" means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto) but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928. The basis in case of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under section 141 of this Act, shall be determined in accordance with regulations prescribed under section 141 (b).

(b) Property acquired before March 1, 1913.—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property (or, in the case of such property as is described in subsection (a) (1), (4), (5), or (12) of this section, the basis as therein provided), or

(2) the fair market value of such property as of March 1, 1913, whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

ART. 591. **Basis for determining gain or loss from sale.**—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, is, in general, the cost of such property. This general rule is, however, subject to the exceptions set forth in section 113 and articles 592–604. The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, is (1) the cost of such property (or, in the case of such property as is described in paragraphs

(1), (4), and (5) of section 113 (a) and articles 592, 595, and 596, the basis therein provided); or (2) the fair market value of such property as of March 1, 1913; whichever is greater.

What the fair market value of property was on March 1, 1913, is a question of fact to be established by competent evidence. In determining the fair market value of stock in a corporation, due regard shall be given to the fair market value of the corporate assets on the basic date. In the case of property traded in on public exchanges, actual sales at or about the basic date afford evidence of value, but in each case the nature and extent of the sales and the circumstances under which they were made must be considered. Thus, prices received at forced sales or prices received for small lots of property may be no real indication of the value of the property.

ART. 592. **Property included in inventory.**—If the property should have been included in the last inventory, the basis for determining the gain or loss from its sale or other disposition is the last inventory value. But see section 113 (b) and article 591 as to property acquired before March 1, 1913. See section 22 (c) and articles 101–108 with reference to the requirements of inventories.

ART. 593. **Property acquired by gift after December 31, 1920.**—If the property was acquired by gift after December 31, 1920 (even though the gift was made in contemplation of, or was intended to take effect in possession or enjoyment at or after, the donor's death), the basis is the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift. If the donee is unable to ascertain the facts necessary to determine the basis, he shall so state upon his return, and the Commissioner will, if possible, obtain such facts from the donor or last preceding owner, or any other person cognizant thereof. If the Commissioner finds it impossible to obtain such facts, the basis shall be the fair market value of the property as found by the Commissioner as of the date or approximate date at which, according to the best information the Commissioner is able to obtain, the property was acquired by the donor or last preceding owner by whom it was not acquired by gift. In order to insure a fair and adequate appraisal or determination of the proper basis, persons making gifts of property should preserve an accessible record of the facts necessary to determine the cost of such property and its fair market value as of March 1, 1913, where pertinent.

ART. 594. **Property acquired by transfer in trust after December 31, 1920.**—In the case of property acquired after December 31, 1920, by a transfer in trust, other than by a transfer in trust by bequest or devise, the basis shall be the same as it would be in the hands of the

grantor, increased in the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made. This article applies to property acquired after December 31, 1920, by a transfer in trust, even though such transfer was made in contemplation of, or was intended to take effect in possession or enjoyment at or after, the grantor's death. However, neither this article nor article 593 applies to such property interests received by the taxpayer as are described in paragraph (*a*) (2) of article 595. Nor does either article apply to property sold or disposed of after the death of the grantor where such property was transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust. (See article 596.)

ART. 595. **Property acquired by gift or transfer in trust on or before December 31, 1920.**—(*a*) In computing the gain or loss from the sale or other disposition of property acquired by gift or by a transfer in trust on or before December 31, 1920, the basis (except as stated in (*b*) of this article) shall be the fair market value of such property at the time of acquisition. The provisions of this article shall apply to—

(1) Such property interests as the taxpayer has acquired on or before December 31, 1920, as the result of a gift or a transfer in trust, whether or not made in contemplation of death or intended to take effect in possession or enjoyment at or after death, and

(2) Such property interests as passed to the taxpayer under a general power of appointment exercised either by will or by deed executed in contemplation of death or intended to take effect in possession or enjoyment at or after death, regardless of whether such property interests were acquired by the taxpayer on or before December 31, 1920, or after that date.

(*b*) In the case of property acquired by gift or transfer in trust prior to March 1, 1913, the gain or loss from the sale or other disposition thereof shall be computed upon the basis provided in section 113 (b) and article 591.

ART. 596. **Property transmitted at death.**—In the following cases the basis for determining gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the fair market value of the property at the time of the death of the decedent:

(1) Personal property acquired by specific bequest;

(2) Real property acquired by general or specific devise or by intestacy; and

(3) Property, whether real or personal, in the hands of a decedent's estate, acquired by the estate from the decedent (see article 863).

In all other cases where property was acquired either by will or by intestacy after February 28, 1913, the basis shall be the fair market value of the property at the time of its distribution to the taxpayer.

In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death. Accordingly, if a person is entitled to personal property under such a trust instrument after the grantor's death and if such property would be deemed to be acquired by bequest, other than by specific bequest, were the trust instrument a will, the basis of the property, if acquired after February 28, 1913, would be its fair market value at the time it was distributed to the taxpayer. In all other cases where a person is entitled to property, whether real or personal, under such a trust instrument after the grantor's death, the basis of the property, if acquired after February 28, 1913, shall be its fair market value at the time of the grantor's death.

If the property was acquired prior to March 1, 1913, the gain or loss from the sale or other disposition thereof shall be computed upon the basis provided in section 113 (b) and article 591.

For the purposes of this article, the value of property as appraised for the purpose of the Federal estate tax or in the case of estates not subject to that tax, its value as appraised in the State court for the purpose of State inheritance taxes shall be deemed to be its fair market value at the time of the death of the decedent.

ART. 597. **Property acquired upon an exchange.**—In the case of property acquired after February 28, 1913, upon an exchange described in section 112 (b), (c), (d), or (e) (see articles 572–577), the basis is the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made.

Example: A purchased a share of stock in the X Corporation in 1919 for $100. Pursuant to a plan of reorganization, A in 1928 exchanged his share for one share in the Y Corporation, worth $90, and $30 in cash. Under the provisions of section 112 (c) (see article 575), A realized a taxable gain of $20 from this exchange. The basis of the share of stock in the Y Corporation is $90; that is, the basis of the share in the X Corporation ($100) less the amount of

money received by A ($30) plus the amount of gain recognized on the exchange ($20).

If the property which was acquired upon an exchange described in section 112 (c), (d), or (e) (see articles 573 and 575) consisted in part of the type of property permitted by paragraph (1), (2), (3), or (4) of section 112 (b) to be received without the recognition of gain or loss, and in part of other property, the basis provided in the first paragraph of this article shall be allocated between the properties (other than money) received. For the purpose of this allocation there shall be assigned to such other property an amount equivalent to its fair market value at the date of the exchange.

Example: A purchased a share of stock in the X Corporation in 1920 for $100. Upon a reorganization of the X Corporation in 1928, A received in place of his stock in the X Corporation a share of stock in the Y Corporation worth $60, a Liberty bond worth $50, and in addition $20 in cash. Under section 112 (c) (1), A realized a gain of $30 from the exchange. The basis of the property received in exchange is the basis of the old stock ($100) decreased in the amount of money received ($20) and increased in the amount of gain that was realized ($30) which results in a basis for the property received of $110. This basis of $110 is apportioned between the Liberty bond and the share of stock, the basis for determining gain or loss from a subsequent disposition of the Liberty bond being its fair market value at the date of the exchange, $50, and of the share of stock, the remainder, $60.

This article does not apply in ascertaining the basis for determining gain or loss of property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it. (See articles 598 and 599.)

ART. 598. **Property acquired in reorganization after December 31, 1917.**—In the case of property which was acquired after December 31, 1917, by a corporation in connection with a reorganization, if immediately after the transfer an interest or control in such property of 80 per cent or more remained in the same persons or in any of them, the basis for determining gain or loss from the sale or other disposition of the property shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law which was applicable to the year in which the transfer was made.

Example: The X Corporation owns property which it purchased in 1921 for $10,000. It causes the organization of the Y Corporation,

transferring the property to the Y Corporation in exchange for its capital stock. No gain or loss from this transaction is recognized under section 112 (b) (4). The basis for determining the gain or loss from the subsequent sale or other disposition of the property is $10,000, the basis which the property would have in the hands of the X Corporation.

This article shall not apply if the property acquired consists of stock or securities in a corporation a party to a reorganization unless such stock or securities are acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer. The application of this article to a case where such stock or securities are acquired by the issuance of stock or securities of the transferee may be illustrated as follows:

Example: The Y Corporation owns all of the stock of the X Corporation, which stock it acquired in 1928 by the issuance of all of its own stock to the individual shareholders of the X Corporation. The stock of the X Corporation was acquired by the individuals in 1920 for $100,000 in cash. The stock of the Y Corporation had a fair market value of $1,000,000 at the time it was exchanged in 1928 for the stock of the X Corporation. The fair market value of the stock of the X Corporation at the time of the exchange in 1928 was also $1,000,000. The basis for determining the gain or loss to the Y Corporation from the subsequent sale or other disposition of the stock of the X Corporation is the basis which such stock would have in the hands of the individuals from whom it was acquired by the Y Corporation, that is, $100,000.

ART. 599. **Property acquired after December 31, 1920, by a corporation.**—In the case of property acquired after December 31, 1920, by a corporation by the issuance of its stock or securities in exchange for such property, in accordance with the conditions specified in section 112 (b) (5), the basis of such property shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon the transfer under the law applicable to the year in which the transfer was made. This article also applies to cases in which part of the consideration for the transfer of property to the corporation was property or money in addition to stock or securities, provided that the other conditions specified in section 112 (b) (5) are satisfied.

It should be noted that property may be acquired in connection with a reorganization without the provisions of section 113 (a) (7) and article 598 being applicable, because of the fact that an interest or control of 80 per cent or more does not remain in the same persons. If, however, such a transaction falls within the provisions

of this article, the limitations imposed herein upon the basis of such property are applicable.

ART. 600.[1] **Stock or securities distributed in reorganization.**—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112 (g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost or other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are distributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class.

(3) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the identity of the lots can not be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see article 58), and any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

(4) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the stock distributed in reorganization can not be identified as having been distributed in respect of any particular lot of such stock, then any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

ART. 601. **Property acquired by an involuntary conversion.**—In the case of property acquired after February 28, 1913, as the result of an involuntary conversion described in section 112 (f) and article 579, the basis of the property shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which the conversion was made.

[1] See T. D. 4274, p. 358.

Example: A vessel purchased by A in 1919 for $100,000 is destroyed in 1928, and A receives insurance in the amount of $200,000. Disregarding the element of depreciation, if A invests $150,000 in a new vessel, taxable gain to the extent of $50,000 would be recognized. If the new vessel is subsequently sold, the basis for determining gain or loss is $100,000; that is, the cost of the old vessel ($100,000) minus the money received by the taxpayer which was not expended in the acquisition of the new vessel ($50,000) plus the amount of gain recognized upon the conversion ($50,000).

ART. 602. **Stock or securities acquired in "wash sales."**—If substantially identical property was acquired after December 31, 1920, in place of stock or securities which were sold or disposed of and in respect of which loss was not allowed as a deduction under section 118 of this Act, or section 214 (a) (5) or 234 (a) (4) of the Revenue Act of 1921, the Revenue Act of 1924, or the Revenue Act of 1926, the basis in the case of the new property shall be the same as the basis of the stock or securities so sold or disposed of, increased in the amount of any excess of the repurchase price over the sale price, or decreased by the amount by which the sale price exceeds the repurchase price, as the case may be.

Example: A purchased a share of common stock for $100 in 1922, which he sold January 15, 1928, for $80. On February 1, 1928, he purchased a share of common stock in the same corporation for $90. No loss from the sale is recognized under section 118. The basis for determining gain or loss from the sale of the new share is $110; that is, the basis of the old share ($100) increased by $10, the amount of the difference between the price for which sold ($80) and the repurchase price ($90).

ART. 603. **Basis of property acquired during affiliation.**—The basis for determining gain or loss by a corporation from the sale or other disposition of property acquired by it during a period of affiliation from a corporation with which it was affiliated shall be the same as it would be in the hands of the corporation from which acquired. This is true whether the property was sold or disposed of during or after the period of affiliation. For the purpose of this article, the term "period of affiliation" means the period during which such

corporations were affiliated (determined in accordance with the law applicable thereto) but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928.

Example: The X Corporation, the Y Corporation, and the Z Corporation were affiliated for the taxable year 1920. During that year the X Corporation transferred assets to the Y Corporation for $120,000 cash, and the Y Corporation in turn transferred the assets during the same year to the Z Corporation for $130,000 cash. The assets were acquired by the X Corporation in 1916 at a cost of $100,000. The basis for determining gain or loss from the subsequent sale or other disposition of the assets by the Z Corporation is $100,000.

This article shall not apply to assets acquired by a corporation during the taxable year 1917 from a corporation with which it was affiliated during that year.

ART. 604. **Readjustment of partnership interests.**—When a partner retires from a partnership, or it is dissolved, he realizes a gain or loss measured by the difference between the price received for his interest and the cost to him of his interest in the partnership, including in such cost the amount of his share in any undistributed partnership net income earned since he became a partner on which the income tax has been paid. However, if such interest in the partnership was acquired prior to March 1, 1913, both the cost as hereinbefore provided and the value of such interest as of such date, plus the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid, shall be ascertained, and the gain derived or the loss sustained shall be computed as provided in article 561. If the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received in liquidation. Whenever a new partner is admitted to a partnership, or any existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain or loss has been realized by any partner.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) **Basis for depreciation.**—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in section 113 for the purpose of determining the gain or loss upon the sale or other disposition of such property.

(b) **Basis for depletion—**

(1) GENERAL RULE.—The basis upon which depletion is to be allowed in respect of any property shall be the same as is provided in section 113 for the purpose of determining the gain or loss upon the sale or other disposition of such property, except as provided in paragraphs (2) and (3) of this subsection.

(2) DISCOVERY VALUE IN CASE OF MINES.—In the case of mines discovered by the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. The depletion allowance based on discovery value provided in this paragraph shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value. Discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February 28, 1913, if the vein or deposit thus discovered was not merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit.

(3) PERCENTAGE DEPLETION FOR OIL AND GAS WELLS.—In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

ART. 611. **Basis for allowance of depreciation and depletion.**—The basis upon which exhaustion, wear and tear, obsolescence, and depletion will be allowed in respect of any property is the same as is provided in section 113 for the purpose of determining the gain or loss from the sale or other disposition of such property, except that:

(1) In the case of mines discovered by the taxpayer after February 28, 1913, and not acquired as the result of purchase of a proven tract or lease, the basis for depletion shall be the fair market value of the property at the date of discovery or within 30 days thereafter, if the fair market value is materially disproportionate to the cost. The depletion allowance based on discovery value shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance be less than it would be if computed without reference to discovery value.

(2) With respect to oil and gas wells, the allowance for depletion shall be 27½ per cent of the gross income from the property during the taxable year, but such allowance shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. In no case shall the deduction for depletion with respect to oil and gas wells be less than it would be if computed without reference to section 114 (b) (3) and this paragraph.

See articles 201–210 for the methods of computing allowances for depreciation, and articles 221–257 with reference to the allowance for depletion.

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) Definition of dividend.—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) Source of distributions.—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) Distributions in liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

(d) Other distributions from capital.—If any distribution (not in partial or complete liquidation) made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. The provisions of this subsection shall also

apply to distributions from depletion reserves based on the discovery value of mines.

(e) Distributions by personal service corporations.—Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 or section 218 of the Revenue Act of 1921, shall be exempt from tax to the distributees.

(f) Stock dividends.—A stock dividend shall not be subject to tax.

(g) Redemption of stock.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend. In the case of the cancellation or redemption of stock not issued as a stock dividend this subsection shall apply only if the cancellation or redemption is made after January 1, 1926.

(h) Definition of partial liquidation.—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

ART. 621. **Dividends.**—The term "dividends" for the purpose of Title I (except when used in sections 203 (a) (4) and 208 (c) (1)) comprises any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of its earnings or profits accumulated since February 28, 1913. Although interest on State bonds and certain other obligations is not taxable when received by a corporation, upon amalgamation with the other funds of the corporation such income loses its identity and when distributed to shareholders in dividends is taxable to the same extent as other dividends.

A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands. (See article 333.)

ART. 622. **Source of distribution.**—For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits.

ART. 623. **Distributions out of earnings or profits accumulated, or increase in value of property accrued, prior to March 1, 1913.**—Any distribution by a corporation out of earnings or profits accumulated prior to

March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition, and, if realized, whether prior to or on or after March 1, 1913), is not a dividend within the meaning of Title I. A corporation can not distribute earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, exempt from tax, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. Whenever one corporation receives from another corporation distributions out of earnings or profits accumulated by such other corporation prior to March 1, 1913, or out of increase in value of its property accrued prior to March 1, 1913, and the "receiving" corporation, after having first distributed all of its earnings and profits accumulated since February 28, 1913, distributes to its shareholders the amount so received by it from such other corporation, the distribution by the "receiving" corporation to its shareholders is not a dividend within the meaning of Title I and is exempt from tax.

In determining whether a dividend is out of earnings or profits accumulated since February 28, 1913, or prior to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

A tax-free distribution made by a corporation out of earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, shall be applied against the basis of the stock for the purpose of determining gain or loss from its subsequent sale. The fact that such distribution is in excess of the cost or other basis (provided in section 113 and articles 591–604) of the stock on which declared does not render it subject to tax. The provisions of this paragraph are also applicable to a distribution by a "receiving" corporation made under the conditions set forth in the first paragraph of this article, and to the distributees in determining gain or loss from the subsequent sale or other disposition of stock in the "receiving" corporation.

Example: A purchased certain shares of stock subsequent to February 28, 1913, for $10,000. He received in 1928 a distribution of $2,000 paid out of earnings and profits of the corporation accumulated prior to March 1, 1913. This distribution is not subject to tax if the earnings and profits of the corporation accumulated after February 28, 1913, have been distributed. If A subsequently sells the stock for $6,000, a deductible loss of $2,000 is sustained. If he sells the stock for $9,000, he realizes a taxable gain of $1,000.

ART. 624. **Distributions other than those out of increase in value of property accrued prior to March 1, 1913, or out of earnings or profits.**—Any distribution (not in partial or complete liquidation) made by a corporation to its shareholders otherwise than out of increase in value of property accrued prior to March 1, 1913, or earnings or profits, shall be taxable to the recipient only if and to the extent that such distribution exceeds the basis of his stock as provided in section 113 and articles 591–604. Any such distribution, however, shall be applied against and reduce the cost or other basis of the stock upon which declared, for the purpose of determining the gain or loss from the subsequent disposition of the stock.

Example: A purchased certain stock in 1918 for $10,000. If he receives in 1928 a distribution thereon of $2,000 paid by the corporation otherwise than out of its earnings or profits or the increase in value of property accrued prior to March 1, 1913, this distribution does not constitute taxable income to A. If A subsequently sells the stock, the difference between the amount realized therefor and $8,000 is taxable gain or deductible loss, as the case may be. If, however, A receives a distribution of $12,000 in 1928, paid by the corporation otherwise than out of its earnings or profits or the increase in value of property accrued prior to March 1, 1913, A realizes taxable income to the extent of $2,000, which at his option may be taxed as a capital gain. (See section 101 and article 501.)

ART. 625. **Distributions in liquidation.**—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. The phrase "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of the corporate stock may be accomplished, for example, by the complete retirement of all the shares of a particular preference or series, or by taking up all the old shares of a particular preference or series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of the stock, whether or not pro rata among the shareholders.

The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and article 561, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113 and articles 591–604;

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but the gain or loss will be recognized only to the extent provided in section 112 and articles 571–580. Any gain to the shareholder may, at his option, be taxed as a capital net gain in the manner and subject to the conditions prescribed in section 101 and articles 501–503. In the case of amounts distributed in partial liquidation, other than a distribution in pursuance of a plan of reorganization as described in section 112 (h), the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of section 115 (b) for the purpose of determining the taxability of subsequent distributions by the corporation.

Example (1): A owns 10 shares of stock in the M Corporation for which he paid $1,250 in 1923. He receives in 1928 a dividend of $1,500 in complete liquidation. A is subject both to the normal tax and to the surtax upon his profit of $250 or at his option, in lieu of such taxes, to the tax upon capital net gain.

Example (2): A owns 10 shares of preferred stock and 10 shares of common stock in the M Corporation which he purchased in 1918 for $1,100 and $1,000, respectively. In 1928 the M Corporation has on hand $225,000 of capital, earnings and profits of $25,000 accumulated prior to March 1, 1913, and earnings and profits of $125,000 accumulated after February 28, 1913. The preferred stock is retired at $125 per share, $125,000 being used by the corporation for this purpose. A receives $1,250 in exchange for his 10 shares of preferred stock and is therefore subject to the normal tax and the surtax on $150, or at his option, in lieu of such taxes, to the tax upon capital net gain. The M Corporation then distributes a cash dividend of $25,000 on the common stock, which is subject only to the surtax. Without any further accumulation of earnings and profits, the M Corporation thereafter liquidates completely. A receives $2,250 in exchange for his 10 shares of common stock and is therefore subject to the normal tax and the surtax on $1,250, or at his option, in lieu of such taxes, to the tax upon capital net gain.

ART. 626. **Distributions from depletion or depreciation reserves.**—A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which ordinary dividends may be paid. A distribution made from a depletion or a depreciation reserve based upon the cost of the property will not be considered as having been paid out of earnings or profits, but the amount thereof shall be applied against and reduce the cost or other basis of the stock upon which declared for the purpose of determining the gain or loss from the subsequent disposition of the stock. If such a distribution is in excess of the basis, the excess shall be taxed as a gain from the sale or other disposition of property. A distribution made from a depletion reserve based on the discovery value of a mine shall be similarly treated (by virtue of section 115 (d)), but a distribution from any other depletion reserve based upon discovery value, to the extent that such reserve represents the excess of the discovery value over cost or March 1, 1913, value, is, when received by the shareholders, taxable as an ordinary dividend. In the case of oil and gas wells the amount by which a corporation's depletion allowance for any taxable year based upon the income from the property (see section 114 (b) (3) and articles 241 and 611) exceeds a depletion allowance computed without reference to section 114 (b) (3), constitutes a part of the corporation's "earnings or profits accumulated after February 28, 1913," within the meaning of section 115, and, upon distribution to shareholders, is taxable to them as a dividend. A distribution made from that portion of a depletion reserve based upon a valuation as of March 1, 1913, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings or profits, but the amount of the distribution shall be applied against and reduce the cost or other basis of the stock upon which declared for the purpose of determining the gain or loss from the subsequent disposition of the stock. No distribution, however, can be made from such a reserve until all the earnings or profits of the corporation have first been distributed.

ART. 627. **Dividends paid in property.**—Dividends paid in securities or other property (other than its own stock) in which the earnings of a corporation have been invested, are income to the recipients to the amount of the market value of such property when receivable by the shareholders. (See, however, section 112 (h) and article 576.) Where a corporation declares a dividend payable in stock of another corporation, setting aside the stock to be so distributed and notifying the shareholders of its action, the income arising to the recipients of such stock is its market value at the time the dividend becomes payable. (See article 333.) Scrip dividends are subject to tax in the year in which the warrants are issued.

ART. 628. **Stock dividends.**—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

ART. 629. **Distribution in redemption or cancellation of stock taxable as a dividend.**—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, so that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. A bona fide distribution in complete cancellation or redemption of all of the stock of a corporation, or one of a series of bona fide distributions in complete cancellation or redemption of all of the stock of a corporation, is not essentially equivalent to the distribution of a taxable dividend. Where a distribution is made pursuant to a corporate resolution reciting that the distribution is made in liquidation of the corporation, and the corporation is completely liquidated and dissolved within one year after the distribution, the distribution will not be considered essentially equivalent to the distribution of a taxable dividend; in all other cases the facts and circumstances should be reported to the Commissioner for his determination whether or not the distribution, or any part thereof, is essentially equivalent to the distribution of a taxable dividend.

SEC. 116. EXCLUSIONS FROM GROSS INCOME.

In addition to the items specified in section 22 (b), the following items shall not be included in gross income and shall be exempt from taxation under this title:

(a) **Earned income from sources without United States.**—In the case of an individual citizen of the United States, a bona fide nonresident of the United States for more than six months during the taxable year, amounts received from sources without the United States if such amounts constitute earned income as defined in section 31; but such

individual shall not be allowed as a deduction from his gross income any deductions properly allocable to or chargeable against amounts excluded from gross income under this subsection.

(b) **Teachers in Alaska and Hawaii.**—In the case of an individual employed by Alaska or Hawaii or any political subdivision thereof as a teacher in any educational institution, the compensation received as such. This subsection shall not exempt compensation paid directly or indirectly by the Government of the United States.

(c) **Income of foreign governments.**—The income of foreign governments received from investments in the United States in stocks, bonds, or other domestic securities, owned by such foreign governments, or from interest on deposits in banks in the United States of moneys belonging to such foreign governments, or from any other source within the United States.

(d) **Income of States, municipalities, etc.**—Income derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, or income accruing to the Government of any possession of the United States, or any political subdivision thereof.

Whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, prior to September 8, 1916, entered in good faith into a contract with any person, the object and purpose of which is to acquire, construct, operate, or maintain a public utility—

(1) If by the terms of such contract the tax imposed by this title is to be paid out of the proceeds from the operation of such public utility, prior to any division of such proceeds between the person and the State, Territory, political subdivision, or the District of Columbia, and if, but for the imposition of the tax imposed by this title, a part of such proceeds for the taxable year would accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then a tax upon the net income from the operation of such public utility shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title, but there shall be refunded to such State, Territory, political subdivision, or the District of Columbia (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this title) would have accrued directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, bears to the amount of the net income from the operation of such public utility for such taxable year.

(2) If by the terms of such contract no part of the proceeds from the operation of the public utility for the taxable year would, irrespective of the tax imposed by this title, accrue directly to or for the use of such State, Territory, political subdivision, or the District of Columbia, then the tax upon the net income of such person from the operation of such public utility shall be levied, assessed,

collected, and paid in the manner and at the rates prescribed in this title.

(e) Bridges to be acquired by State or political subdivision.[1]—Whenever any State or political subdivision thereof, in pursuance of a contract to which it is not a party entered into before the enactment of this Act, is to acquire a bridge—

(1) If by the terms or such contract the tax imposed by this title is to be paid out of the proceeds from the operation of such bridge prior to any division of such proceeds, and if, but for the imposition of the tax imposed by this title, a part of such proceeds for the taxable year would accrue directly to or for the use of or would be applied for the benefit of such State or political subdivision, then a tax upon the net income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title, but there shall be refunded to such State or political subdivision (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this title) would have accrued directly to or for the use of or would be applied for the benefit of such State or political subdivision, bears to the amount of the net income from the operation of such bridge for such taxable year. No such refund shall be made unless the entire amount of the refund is to be applied in part payment for the acquisition of such bridge.

(2) If by the terms of such contract no part of the proceeds from the operation of the bridge for the taxable year would, irrespective of the tax imposed by this title, accrue directly to or for the use of or be applied for the benefit of such State or political subdivision, then the tax upon the net income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title.

(f) Dividends from "China Trade Act" corporation.—In the case of a person, amounts distributed as dividends to or for his benefit by a corporation organized under the China Trade Act, 1922, if, at the time of such distribution, he is a resident of China, and the equitable right to the income of the shares of stock of the corporation is in good faith vested in him.

(g) Shipowners' protection and indemnity associations.—The receipts of shipowners' mutual protection and indemnity associations not organized for profit, and no part of the net earnings of which inures to the benefit of any private shareholder; but such corporations shall be subject as other persons to the tax upon their net income from interest, dividends, and rents.

ART. 641. **Income of foreign governments, ambassadors, and consuls.**—The exemption of the income of foreign governments applies also to their political subdivisions. Any income collected by foreign governments from investments in the United States in stocks, bonds, or other domestic securities, which are not actually owned by but are loaned to such foreign governments, is subject to tax.

[1] See T. D. 4303, p. 359.

Ambassadors and ministers accredited to the United States and the members of their households (including secretaries, attachés, and servants) who are not citizens of the United States, are exempt from the payment of Federal income tax upon their salaries, fees, or wages. The income from investments in the United States in bonds and stocks and from interest on bank balances received by ambassadors and ministers accredited to the United States, who are not citizens of the United States, is exempt from tax, but income from any business carried on by them in the United States is taxable. These provisions are also applicable to the wives and minor children of foreign ambassadors and ministers and the members of their households, including secretaries, attachés, and servants.

All foreign consular officers and employees in foreign consulates in the United States who are nationals of the States appointing them are exempt from Federal income tax with respect to wages, fees, and salaries received by them in compensation for their consular services, provided the appointing State grants a similar exemption to citizens of the United States who are American consular officers or employees of the American consulates in such State. The income received by foreign consular officers and employees of foreign consulates from investments in the United States in bonds and stocks and from interest on bank balances as well as income from any business carried on by them in the United States is subject to Federal income tax.

The compensation of citizens of the United States who are officers or employees of a foreign government is not exempt from income tax. (But see section 116 (a).)

ART. 642. **Income of States.**—Income derived from any public utility or from the exercise of any essential governmental function and accruing to any State or Territory of the United States, to any political subdivision thereof, or to the District of Columbia, or income accruing to the government of any possession of the United States, or any political subdivision thereof, is exempt from tax. The income of State workmen's compensation insurance funds established by State statutes is not taxable.

ART. 643. **Compensation of State officers and employees.**—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (*a*) the person receives such compensation as an officer or

employee of a State or political subdivision, and (*b*) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are subject to tax for 1928 and subsequent taxable years.

An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary. Employees of universities receiving salaries paid in part or in whole from funds available under the Smith-Lever Act of May 8, 1914, who are officers or employees of a State, are not required to return as taxable income the salaries so received. This is also true with respect to the Act of August 30, 1890, relating to colleges for the benefit of agriculture and the mechanic arts, and to the Act of March 2, 1887, relating to agricultural experiment stations in such colleges. As to State contracts, see article 56.

SEC. 117. NET LOSSES.

(a) Definition of "net loss."—As used in this section the term "net loss" means the excess of the deductions allowed by this title over the gross income, with the following exceptions and limitations:

(1) NON-BUSINESS DEDUCTIONS.—Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business;

(2) CAPITAL LOSSES.—In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains;

(3) DEPLETION.—The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value, or to percentage depletion under section 114 (b) (3);

(4) DIVIDENDS.—The deduction provided for in section 23 (p) of amounts received as dividends shall not be allowed;

(5) INTEREST.—There shall be included in computing gross income the amount of interest received free from tax under this title, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b);

(6) NET LOSS NOT TO PRODUCE NET LOSS.—In computing the net loss for any taxable year a net loss for a prior year shall not be allowed as a deduction.

(b) Net loss as a deduction.—If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

(c) Capital net gain or loss in second year.—

(1) CAPITAL NET LOSS.—If in the second year the taxpayer (other than a corporation) sustains a capital net loss, the deduction allowed by subsection (b) of this section shall first be applied as a deduction in computing the ordinary net income for such year. If the deduction is in excess of the ordinary net income (computed without such deduction) then the amount of such excess shall be allowed as a deduction in computing net income for the third year.

(2) CAPITAL NET GAIN.—If in the second year the taxpayer (other than a corporation) has a capital net gain, the deduction allowed by subsection (b) of this section shall first be applied as a deduction in computing the ordinary net income for such year. If the deduction is in excess of the ordinary net income (computed without such deduction) the amount of such excess shall next be applied against the capital net gain for such year, and if in excess of the capital net gain the amount of that excess shall be allowed as a deduction in computing net income for the third year.

(d) Capital net gain or loss in third year.—If any portion of a net loss is allowed as a deduction in computing net income for the third year, under the provisions of either subsection (b) or (c) of this section and the taxpayer (other than a corporation) has in such year a capital net gain or a capital net loss, then the method of allowing such deduction in such third year shall be the same as provided in subsection (c).

(e) Net loss for 1926 or 1927.—If for the taxable year 1926 or 1927 a taxpayer sustained a net loss within the provisions of the Revenue Act of 1926, the amount of such net loss shall be allowed as a deduction in computing net income for the two succeeding taxable years to the same extent and in the same manner as a net loss sustained for one taxable year is, under this Act, allowed as a deduction for the two succeeding taxable years.

(f) Fiscal year returns.—If a taxpayer makes return for a period beginning in one calendar year (hereinafter in this subsection called "first calendar year") and ending in the following calendar year (hereinafter in this subsection called "second calendar year") and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then his net loss for the period ending during the second calendar year shall be the sum of: (1) the same proportion of a net loss for the entire period, determined under the law applicable to the first calendar year, which the portion of such period falling within such calendar year is of the entire period; and (2) the same proportion of a net loss for the entire period, determined under the law applicable to the second calendar year, which the portion of such period falling within such calendar year is of the entire period.

ART. 651. **Net losses, definition and computation.**—The term "net loss" as used in section 117 applies to a net loss during the taxable year in a trade or business regularly carried on by the taxpayer. Included therein are losses from the sale or other disposition of real estate, machinery, and other capital assets used in the conduct of such trade or business. See section 101 and article 503 with reference to the deduction of capital net losses. In order to be entitled to claim an allowance for a "net loss" the taxpayer must have suffered an actual net loss in a trade or business during the taxable year. The amount properly allowed may be neither the loss reflected by the return filed for the purpose of the income tax nor the net loss shown by the taxpayer's profit and loss account, but is to be computed according to the Act.

In the case of an individual the "net loss" is the amount by which the deductions allowed under Title I, excluding:

(*a*) The amount by which the deductions otherwise allowed by law but not attributable to the operation of a trade or business regularly carried on by the taxpayer exceed the amount of gross income not derived from such trade or business;

(*b*) The amount by which the deductions for capital losses otherwise allowed by law exceed the capital gains; and

(*c*) The amount by which the deduction for depletion exceeds the amount which would be allowable if computed without reference to discovery value in the case of mines, or without reference to section 114 (b) (3) in the case of oil and gas wells—

exceed the sum of the following:

(1) The gross income of the taxpayer for the taxable year; and

(2) The amount by which the interest received free from taxation under Title I exceeds the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b).

In the case of a corporation, the "net loss" is the amount by which the deductions allowed under Title I, excluding:

(*a*) The amount by which the deduction for depletion exceeds the amount which would be allowable if computed without reference to discovery value in the case of mines, or without reference to section 114 (b) (3) in the case of oil and gas wells; and

(*b*) The amount received as dividends and allowed as a deduction under section 23 (p)—

exceed the sum of the following:

(1) The gross income of the taxpayer for the taxable year; and

(2) The amount by which the interest received free from tax under the provisions of Title I exceeds the amount of interest paid or

accrued within the taxable year which is not allowed as a deduction by section 23 (b).

ART. 652. **Claim for allowance of net loss.**—A taxpayer sustaining for any taxable year a net loss as defined in section 117 (a) and article 651 may file a claim therefor with his return for the succeeding taxable year (referred to in article 653 as the "second year"). The claim should contain a concise statement setting forth the amount of the net loss and all pertinent facts relative thereto, including a schedule showing the computation of the net loss. If the evidence furnished satisfies the Commissioner that the taxpayer has sustained a net loss, the amount of such net loss may be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year, and if such net loss is in excess of the net income (computed without such deduction) for that year, the amount of the excess may be carried over and allowed as a deduction in computing the net income for the next succeeding taxable year (referred to in article 653 as the "third year"). It should be noticed, however, that a net loss for a preceding year may not be considered in computing a net loss for a succeeding year.

ART. 653. **Net loss and capital net gain or capital net loss.**—If the taxpayer (other than a corporation) sustains in the second year a capital net loss, as defined in section 101 (c) (6) and article 503, the deduction of a net loss allowed by section 117 (b) shall first be applied as a deduction in computing the ordinary net income for that year. If the ordinary net income (computed without such deduction) is in excess of the net loss, the tax shall be computed as provided in section 101 (b) and article 503. If the deduction is in excess of the ordinary net income (computed without such deduction), the amount of the excess of the net loss shall be allowed as a deduction in computing net income for the third year. The capital net loss may not be carried over as a deduction into the third year.

If in the second year the taxpayer (other than a corporation) has a capital net gain, as defined in section 101 (c) (5) and article 501, the deduction of a net loss allowed by section 117 (b) shall first be applied as a deduction in computing the ordinary net income for that year. If the ordinary net income (computed without such deduction) is in excess of the net loss, the tax shall be computed as provided in section 101 (a) and article 501. If the deduction is in excess of the ordinary net income (computed without such deduction) the amount of the excess shall next be applied against the capital net gain for that year, and, if in excess of the capital net

gain, the amount of that excess shall be allowed as a deduction in computing net income for the third year.

If any portion of a net loss is allowed as a deduction in computing net income for the third year, under the provisions of section 117 (b) or (c), and the taxpayer (other than a corporation) has in the third year a capital net gain or a capital net loss, then the method of allowing the deduction in the third year shall be the same as provided in section 117 (c) and the two preceding paragraphs of this article.

ART. 654. **Net losses for 1926 and 1927 and for the fiscal year 1928.**—If a taxpayer sustained a net loss for the taxable year 1926 or 1927 within the provisions of the Revenue Act of 1926, the amount of the net loss shall be allowed as a deduction in computing net income for the two succeeding taxable years to the same extent and in the same manner as a net loss sustained for one taxable year is, under section 117, allowed as a deduction for the two succeeding taxable years.

Where a taxpayer has a fiscal year beginning in 1927 and ending in 1928, his net loss for the period ending during 1928 shall be the sum of—

(1) The same proportion of a net loss for the entire period, determined under the Revenue Act of 1926, which the portion of the period falling within 1927 is of the entire period, and

(2) The same proportion of a net loss for the entire period determined under the Revenue Act of 1928 which the portion of the period falling within 1928 is of the entire period.

ART. 655. **Illustration of computation of net loss.**—The method of computation of net losses as outlined in articles 651–653 may be illustrated as follows:

A, an individual, conducting a trade or a business, finds the following facts relating to 1928:

(*a*) His deductions as computed under Title I amount to $100,000.

(*b*) Included in the deductions is an item of $10,000 for loss by fire of property occupied by him as a residence and not used in connection with his trade or business.

(*c*) Other deductions otherwise allowed under Title I on account of transactions entered into for profit outside of his trade or business amount to $3,000.

(*d*) His taxable gains from transactions entered into for profit and not connected with his trade or business are $5,000.

(*e*) Donations to the Red Cross amounting to $1,000 are included among the deductions.

(*f*) Depletion is claimed in the amount of $2,000, of which $500 is based upon the value of the mineral in the mine as of March 1, 1913, and $1,500 is attributable to increase in valuation on account of discovery subsequent to February 28, 1913.

(*g*) His entire gross income as computed under Title I is $50,000.

(*h*) Interest received from municipal bonds exempted from taxation by section 22 (b) (4) amounted to $10,000.

(*i*) Interest was paid upon money borrowed to carry municipal bonds in the amount of $8,000, which amount is not deductible under section 23 (b):

Total deductions (*a*)		$100,000
Deduct:		
Loss by fire (*b*)	$10,000	
Other deductions (*c*)	3,000	
Total deductions outside business	13,000	
Less: Gain outside business (*d*)	5,000	
Excess of deductions not sustained in trade or business over taxable gains or profits not derived from such trade or business	8,000	
Donations (*e*)	1,000	
Depletion on basis of value after discovery (*f*)	$2,000	
Less: Portion based on values as of Mar. 1, 1913	500	
Portion of depletion representing the excess of depletion based upon discovery value over depletion based upon cost or value as of Mar. 1, 1913	1,500	
Total exclusion from deductions		10,500
Total expenses directly attributable to the conduct of the trade or business		89,500
Gross income (*g*)	50,000	
Add: Nontaxable interest received (*h*)	10,000	
Less: Interest paid on money borrowed to carry municipal bonds (*i*)	8,000	
	2,000	
		52,000
Statutory net loss		37,500

If A has an ordinary net income in 1929 of $25,000 and sustains a capital net loss of $10,000, he will pay no tax for 1929, since he had a net loss in 1928 of $37,500, and will carry over $12,500 as a deduction in computing net income in 1930. If A for 1930 has ordinary net income of $10,000 and a capital net gain of $100,000, he may, at his option, pay a tax of 12½ per cent upon $97,500 under the provisions of section 101 (a) and article 501.

SEC. 118. LOSS ON SALE OF STOCK OR SECURITIES.

In the case of any loss claimed to have been sustained in any sale or other disposition of shares of stock or securities where it appears

that within thirty days before or after the date of such sale or other disposition the taxpayer has acquired (otherwise than by bequest or inheritance) or has entered into a contract or option to acquire substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition, no deduction for the loss shall be allowed under section 23 (e) (2) of this title; nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business. If such acquisition or the contract or option to acquire is to the extent of part only of substantially identical property, then only a proportionate part of the loss shall be disallowed.

ART. 661. **Losses in connection with sale and repurchase of securities.**—A taxpayer, other than one in the trade or business of buying and selling securities, can not deduct any loss claimed to have been sustained from the sale or other disposition of stock or securities, if within 30 days before or after the date of such sale or other disposition he has acquired (otherwise than by bequest or inheritance), or has entered into a contract or option to acquire, substantially identical property, and the property so acquired is held by the taxpayer for any period after such sale or other disposition. If such acquisition or the contract or option to acquire is to the extent of part only of substantially identical property, only a proportionate part of the loss shall be disallowed. See article 602 for the basis for determining gain or loss from the subsequent sale or other disposition of such securities. This provision is designed to prevent a taxpayer who owns securities, other than one in the trade or business of buying and selling securities, from claiming as a deduction in computing net income the so-called "loss" sustained from a sale of securities which is immediately followed or immediately preceded by a purchase of substantially identical securities. Gain or loss, however, is realized in the case of the "short sale." Under this article a taxpayer owning a hundred shares of stock in the X Corporation, who purchases another hundred shares of stock in the X Corporation and within 30 days thereafter sells the first purchased stock of the X Corporation, can not deduct in computing net income any loss claimed to have been sustained from the transaction; if he sells the entire 200 shares of stock, a gain or loss from both transactions is realized at that time; and if he sells the stock of the X Corporation included within the second purchase a gain or loss is realized thereby.

SEC. 119. INCOME FROM SOURCES WITHIN UNITED STATES.

(a) **Gross income from sources in United States.**—The following items of gross income shall be treated as income from sources within the United States:

(1) INTEREST.—Interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including—

(A) interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States and not having an office or place of business therein, or

(B) interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 per centum of the gross income of such resident payor or domestic corporation has been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such payor preceding the payment of such interest, or for such part of such period as may be applicable, or

(C) income derived by a foreign central bank of issue from bankers' acceptances;

(2) DIVIDENDS.—The amount received as dividends—

(A) from a domestic corporation other than a corporation entitled to the benefits of section 251, and other than a corporation less than 20 per centum of whose gross income is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence), or

(B) from a foreign corporation unless less than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of this section;

(3) PERSONAL SERVICES.—Compensation for labor or personal services performed in the United States;

(4) RENTALS AND ROYALTIES.—Rentals or royalties from property located in the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property; and

(5) SALE OF REAL PROPERTY.—Gains, profits, and income from the sale of real property located in the United States.

(b) **Net income from sources in United States.**—From the items of gross income specified in subsection (a) of this section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States.

(c) **Gross income from sources without United States.**—The following items of gross income shall be treated as income from sources without the United States:

(1) Interest other than that derived from sources within the United States as provided in subsection (a) (1) of this section;

(2) Dividends other than those derived from sources within the United States as provided in subsection (a) (2) of this section;

(3) Compensation for labor or personal services performed without the United States;

(4) Rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like properties; and

(5) Gains, profits, and income from the sale of real property located without the United States.

(d) **Net income from sources without United States.**—From the items of gross income specified in subsection (c) of this section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be treated in full as net income from sources without the United States.

(e) **Income from sources partly within and partly without United States.**—Items of gross income, expenses, losses and deductions, other than those specified in subsections (a) and (c) of this section, shall be allocated or apportioned to sources within or without the United States, under rules and regulations prescribed by the Commissioner with the approval of the Secretary. Where items of gross income are separately allocated to sources within the United States, there shall be deducted (for the purpose of computing the net income therefrom) the expenses, losses and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States. In the case of gross income derived from sources partly within and partly without the United States, the net income may first be computed by deducting the expenses, losses or other deductions apportioned or allocated thereto and a ratable part of any expenses, losses or other deductions which can not definitely be allocated to some items or class of gross income; and the portion of such net income attributable to sources within the United States may be determined by processes or formulas of general apportionment prescribed by the Commissioner with the approval of the Secretary. Gains, profits and income from—

(1) transportation or other services rendered partly within and partly without the United States, or

(2) from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States,

or produced (in whole or in part) by the taxpayer without and sold within the United States,

shall be treated as derived partly from sources within and partly from sources without the United States. Gains, profits and income derived from the purchase of personal property within and its sale without the United States or from the purchase of personal property without and its sale within the United States, shall be treated as derived entirely from sources within the country in which sold, except that gains, profits and income derived from the purchase of personal property within the United States and its sale within a possession of the United States or from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States.

(f) **Definitions.**—As used in this section the words "sale" or "sold" include "exchange" or "exchanged"; and the word "produced" includes "created," "fabricated," "manufactured," "extracted," "processed," "cured," or "aged."

ART. 671. **Income from sources within the United States.**—Nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 251 are taxable only upon income from sources within the United States. Citizens of the United States and domestic corporations entitled to the benefits of section 251 are, however, taxable upon income received within the United States, whether derived from sources within or without the United States. (See sections 212 (a), 231 (a), and 251.)

The Act divides the income of such taxpayers into three classes:

(1) Income which is derived in full from sources within the United States;

(2) Income which is derived in full from sources without the United States; and

(3) Income which is derived partly from sources within and partly from sources without the United States.

The taxable income from sources within the United States includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned to sources within the United States.

ART. 672. **Interest.**—There shall be included in the gross income from sources within the United States, of nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations which are entitled to the benefits of section 251, all interest received or accrued, as the case may be, on bonds,

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notes, or other interest-bearing obligations of residents of the United States, whether corporate or otherwise, except:

(*a*) Interest paid on deposits with persons, including individuals, partnerships, or corporations, carrying on the banking business, to persons (nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 251) not engaged in business within the United States, and not having an office or place of business therein;

(*b*) Interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 per cent of the gross income of such resident payor or domestic corporation has been derived from sources within the United States (as determined under the provisions of section 119 and articles 671–684) for the three-year period ending with the close of the taxable year of the payor which precedes the payment of such interest, or for such part of that period as may be applicable; and

(*c*) Income derived by a foreign central bank of issue from bankers' acceptances. A foreign central bank of issue means a bank which is by law or government sanction the principal authority (other than the government itself) issuing instruments intended to circulate as currency. Such banks are generally the custodians of the banking reserves of their countries.

Any taxpayer who excludes from gross income from sources within the United States income of the type specified in paragraph (*a*), (*b*), or (*c*) shall file with his return a statement setting forth the amount of such income and such information as may be necessary to show that the income is of the type specified in those paragraphs.

As to the inclusion in gross income of items received in the United States even though representing income from sources without the United States, in the case of citizens of the United States and domestic corporations entitled to the benefits of section 251, see article 1132.

ART. 673. **Dividends.**—Gross income from sources within the United States includes all dividends, as defined by section 115:

(*a*) From a domestic corporation other than one entitled to the benefits of section 251, and other than a corporation less than 20 per cent of whose gross income is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of section 119, for the three-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence); or

(*b*) From a foreign corporation unless less than 50 per cent of its gross income for the three-year period ending with the close of its taxable year preceding the declaration of such dividends, or for such part of such period as it has been in existence, was derived from sources within the United States.

Dividends will be treated as income from sources within the United States unless the taxpayer submits sufficient data to establish to the satisfaction of the Commissioner that they should be excluded from gross income under (*a*) or (*b*) of this article. (See also section 116 (f).)

ART. 674. **Compensation for labor or personal services.**—Gross income from sources within the United States includes compensation for labor or personal services performed within the United States regardless of the residence of the payor, of the place in which the contract for services was made, or of the place of payment. When a specific amount is paid for labor or personal services performed in the United States, such amount shall be included in the gross income. When no accurate allocation or segregation of compensation for labor or personal services performed in the United States can be made, or when such labor or service is performed partly within and partly without the United States, the amount to be included in the gross income shall be determined by an apportionment on the time basis, i. e., there shall be included in the gross income an amount which bears the same relation to the total compensation as the number of days of performance of the labor or services within the United States bears to the total number of days of performance of labor or services for which the payment is made. Wages received for services rendered inside the territorial limits of the United States are to be regarded as from sources within the United States. The wages of an alien seaman earned on a coastwise vessel are from sources within the United States.

ART. 675. **Rentals and royalties.**—Gross income from sources within the United States includes rentals or royalties from property located within the United States or from any interest in such property, including rentals or royalties for the use of or the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property. The income arising from the rental of property, whether tangible or intangible, located within the United States, or from the use of property, whether tangible or intangible, within the United States, is from sources within the United States.

ART. 676. **Sale of real property.**—Gross income from sources within the United States includes gain, computed under the provisions of sections 111–113, derived from the sale or other disposition of real property located in the United States. For the treatment of capital net gains and capital net losses, see section 101 and articles 501–503.

ART. 677. **Income from sources without the United States.**—Gross income from sources without the United States includes:

(1) Interest other than that specified in section 119 (a) (1) and article 672, as being derived from sources within the United States;

(2) Dividends other than those derived from sources within the United States as provided in section 119 (a) (2) and article 673;

(3) Compensation for labor or personal services performed without the United States (for the treatment of compensation for labor or personal services performed partly within the United States and partly without the United States, see article 674);

(4) Rentals or royalties derived from property without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property (see article 675); and

(5) Gain derived from the sale of real property located without the United States (see sections 111–113).

ART. 678. **Sale of personal property.**—Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold, except that income derived from the purchase of personal property within the United States and its sale within a possession of the United States or from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within and partly from sources without the United States. The word "sold" includes "exchanged." The "country in which sold" ordinarily means the place where the property is marketed. This article does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States. (See article 682.)

ART. 679. **Deductions in general.**—The deductions provided for in Title I shall be allowed to nonresident alien individuals, foreign corporations, and to citizens of the United States and domestic corporations entitled to the benefits of section 251, only if and to the extent

provided in sections 213, 215, 232, 233, and 251 and articles 680–684, 1051, 1071, 1111, and 1133.

ART. 680. **Apportionment of deductions.**—From the items specified in articles 671–676 as being derived specifically from sources within the United States there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any other expenses, losses, or deductions which can not definitely be allocated to some item or class of gross income. The remainder shall be included in full as net income from sources within the United States. The ratable part is based upon the ratio of gross income from sources within the United States to the total gross income.

Example: A nonresident alien individual derived gross income from all sources for 1928 of $180,000. There was included therein:

Interest on bonds of a domestic corporation	$9,000
Dividends on stock of a domestic corporation	4,000
Royalty for the use of patents within the United States	12,000
Gain from sale of real property located within the United States	11,000
Total	36,000

that is, one-fifth of the total gross income was from sources within the United States. The remainder of the gross income was from sources without the United States, determined under article 677.

The expenses of the taxpayer for the year amounted to $78,000. Of these expenses the amount of $8,000 is properly allocated to income from sources within the United States and the amount of $40,000 is properly allocated to income from sources without the United States.

The remainder of the expenses, $30,000, can not be definitely allocated to any class of income. A ratable part thereof, based upon the relation of gross income from sources within the United States to the total gross income, shall be deducted in computing net income from sources within the United States. Thus, there is deducted from the $36,000 of gross income from sources within the United States, expenses amounting to $14,000 (representing $8,000 properly apportioned to the income from sources within the United States and $6,000, a ratable part (one-fifth) of the expenses which could not be allocated to any item or class of gross income). The remainder, $22,000, is the net income from sources within the United States.

ART. 681. **Other income from sources within the United States.**—Items of gross income other than those specified in section 119 (a) and (c) and articles 672–678 shall be allocated or apportioned to sources within or without the United States, as provided in section 119 (e).

The income derived from the ownership or operation of any farm, mine, oil or gas well, other natural deposit, or timber, located within the United States, and from the sale by the producer of the products thereof within or without the United States, shall ordinarily be included in gross income from sources within the United States. If, however, it is shown to the satisfaction of the Commissioner that due to the peculiar conditions of production and sale in a specific case or for other reasons all of such gross income should not be allocated to sources within the United States, an apportionment thereof to sources within the United States and to sources without the United States shall be made as provided in article 682.

Where items of gross income are separately allocated to sources within the United States, there shall be deducted therefrom, in computing net income, the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of other expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income.

ART. 682. **Income from the sale of personal property derived from sources partly within and partly without the United States.**—Items of gross income not allocated by articles 671–678 or 681 to sources within or without the United States shall (unless unmistakably from a source within or a source without the United States) be treated as derived from sources partly within and partly without the United States. Such income derived from the sale of personal property may be divided into two classes: (A) income derived from sources partly within the United States and partly within a foreign country, and (B) income derived from sources partly within the United States and partly within a possession of the United States.

A. The portion of such income derived from sources partly within the United States and partly within a foreign country which is attributable to sources within the United States shall be determined according to the following rules and cases:

Personal property produced and sold.—Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country, or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States shall be treated as derived partly from sources within the United States and partly from sources within a foreign country under one of the cases named below. As used herein the word "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

Case 1 A. Where the manufacturer or producer regularly sells part of his output to wholly independent distributors or other selling

concerns in such a way as to establish fairly an independent factory or production price—or shows to the satisfaction of the Commissioner that such an independent factory or production price has been otherwise established—unaffected by considerations of tax liability, and the selling or distributing branch or department of the business is located in a different country from that in which the factory is located or the production carried on, the net income attributable to sources within the United States shall be computed by an accounting which treats the products as sold by the factory or productive department of the business to the distributing or selling department at the independent factory price so established. In all such cases the basis of the accounting shall be fully explained in a statement attached to the return.

Case 2 A. Where an independent factory or production price has not been established as provided under case 1 A, the net income shall first be computed by deducting from the gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States, the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United States, and the denominator of which consists of the value of the taxpayer's property both within the United States and within the foreign country. The remaining one-half of such net income shall be apportioned in accordance with the gross sales of the taxpayer within the United States and within the foreign country, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the taxpayer's gross sales for the taxable year or period within the United States, and the denominator of which consists of the taxpayer's gross sales for the taxable year or period both within the United States and within the foreign country. The "gross sales of the taxpayer within the United States" means the gross sales made during the taxable year which were principally secured, negotiated, or effected by employees, agents, offices, or branches of the

taxpayer's business resident or located in the United States. The term "gross sales" as used in this paragraph refers only to the sales of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a foreign country or produced (in whole or in part) by the taxpayer within a foreign country and sold within the United States, and the term "property" includes only the property held or used to produce income which is derived from such sales. Such property should be taken at its actual value, which in the case of property valued or appraised for purposes of inventory, depreciation, depletion, or other purposes of taxation shall be the highest amount at which so valued or appraised, and which in other cases shall be deemed to be its book value in the absence of affirmative evidence showing such value to be greater or less than the actual value. The average value during the taxable year or period shall be employed. The average value of property as above prescribed at the beginning and end of the taxable year or period ordinarily may be used, unless by reason of material changes during the taxable year or period such average does not fairly represent the average for such year or period, in which event the average shall be determined upon a monthly or daily basis. Bills and accounts receivable shall (unless satisfactory reason for a different treatment is shown) be assigned or allocated to the United States when the debtor resides in the United States, unless the taxpayer has no office, branch, or agent in the United States.

Case 3 A. Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the processes or formulas herein prescribed, the income derived from sources within the United States.

B. The portion of such income derived from sources partly within the United States and partly within a possession of the United States which is attributable to sources within the United States shall be determined according to the following rules and cases:

Personal property produced and sold.—Gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a possession of the United States, or produced (in whole or in part) by the taxpayer within a possession of the United States and sold within the United States shall be treated as derived partly from sources within the United States and partly from sources within a possession of the United States under one of the cases named below. As used herein

the word "produced" includes created, fabricated, manufactured, extracted, processed, cured, or aged.

Case 1 B. Same as case 1 A.

Case 2 B. Where an independent factory or production price has not been established as provided under case 1 A, the net income shall first be computed by deducting from the gross income derived from the sale of personal property produced (in whole or in part) by the taxpayer within the United States and sold within a possession of the United States, or produced (in whole or in part) by the taxpayer within a possession of the United States and sold within the United States, the expenses, losses, or other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. Of the amount of net income so determined, one-half shall be apportioned in accordance with the value of the taxpayer's property within the United States and within the possession of the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the value of the taxpayer's property within the United States, and the denominator of which consists of the value of the taxpayer's property both within the United States and within the possession of the United States. The remaining one-half of such net income shall be apportioned in accordance with the total business of the taxpayer within the United States and within the possession of the United States, the portion attributable to sources within the United States being determined by multiplying such one-half by a fraction the numerator of which consists of the amount of the taxpayer's business for the taxable year or period within the United States, and the denominator of which consists of the amount of the taxpayer's business for the taxable year or period both within the United States and within the possession of the United States. The "business of the taxpayer" as that term is used in this paragraph shall be measured by the amounts which the taxpayer paid out during the taxable year or period for wages, salaries, and other compensation of employees and for the purchase of goods, materials, and supplies consumed in the regular course of business, plus the amounts received during the taxable year or period from gross sales, such expenses, purchases, and gross sales being limited to those attributable to the production (in whole or in part) of personal property within the United States and its sale within a possession of the United States or to the production (in whole or in part) of personal property within a possession of the United States and its sale within the United States.

The term "property" as used in this paragraph includes only the property held or used to produce income which is derived from such sales.

Case 3 B. Same as case 3 A.

Personal property purchased and sold.—Gross income derived from the purchase of personal property within the United States and its sale within a possession of the United States and from the purchase of personal property within a possession of the United States and its sale within the United States shall be treated as derived partly from sources within the United States and partly from sources within a possession of the United States under one of the following cases:

Case I B. The net income shall first be computed by deducting from such gross income the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The amount of net income so determined shall be apportioned in accordance with the total business of the taxpayer within the United States and within the possession of the United States, the portion attributable to sources within the United States being that percentage of such net income which the amount of the taxpayer's business for the taxable year or period within the United States bears to the amount of the taxpayer's business for the taxable year or period both within the United States and within the possession of the United States. The "business of the taxpayer" as that term is used in this paragraph shall be measured by the amounts which the taxpayer paid out during the taxable year or period for wages, salaries, and other compensation of employees and for the purchase of goods, materials, and supplies sold or consumed in the regular course of business, plus the amount received during the taxable year or period from gross sales, such expenses, purchases, and gross sales being limited to those attributable to the purchase of personal property within the United States and its sale within a possession of the United States or to the purchase of personal property within a possession of the United States and its sale within the United States.

Case II B. Same as case 3 A.

ART. 683. **Transportation service.**—A foreign corporation carrying on the business of transportation service between points in the United States and points outside the United States derives income partly from sources within and partly from sources without the United States.

(1) The gross income from sources within the United States derived from such services shall be determined by taking such a portion of the total gross revenues therefrom as (*a*) the sum of the costs or expenses of such transportation business carried on by the taxpayer within the United States and a reasonable return upon the property used in its transportation business while within the United States bears to (*b*) the sum of the total costs or expenses of such transportation business carried on by the taxpayer and a reasonable return upon the total property used in such transportation business. Revenues from operations incidental to transportation services (such as the sale of money orders) shall be apportioned on the same basis as direct revenues from transportation services.

In allocating the total costs or expenses incurred in such transportation business, costs or expenses incurred in connection with such part of the services as was wholly rendered in the United States should be assigned to the cost of transportation business within the United States. For example, expenses of loading and unloading in the United States, rentals, office expenses, salaries, and wages wholly incurred for services rendered to the taxpayer in the United States belong to this class. Costs and expenses incurred in connection with services rendered partly within and partly without the United States may be prorated on a reasonable basis between such services. For example, ship wages, charter money, insurance, and supplies chargeable to voyage expenses should ordinarily be prorated for each voyage on the basis of the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days on the voyage, and fuel consumed on each voyage may be prorated on the basis of the proportion which the number of miles sailed within the territorial limits of the United States bears to the total number of miles sailed on the voyage. Income, war-profits, and excess-profits taxes should not be regarded as costs or expenses for the purpose of determining the proportion of gross income from sources within the United States; and for such purpose, interest and other expenses for the use of borrowed capital should not be taken into the cost of services rendered, for the reason that the return upon the property used measures the extent to which such borrowed capital is the source of the income. For other expenses entering into the cost of services, only such expenses as are allowable deductions under the Revenue Act of 1928 should be taken.

The value of the property used should be determined upon the basis of cost less depreciation. Eight per cent may ordinarily be taken as a reasonable rate of return to apply to such property. The property taken should be the average property employed in the

transportation service between points in the United States and points outside the United States during the taxable year. Current assets should be decreased by current liabilities and allocated to services between the United States and foreign countries and to other services. The part allocated to services between the United States and foreign countries should be based on the proportion which the gross receipts from such services bear to the gross receipts from all services. The amount so allocated to services between the United States and foreign countries should be further allocated to services rendered within the United States and to services rendered without the United States. The portion allocable to services rendered within the United States should be based on the proportion which the expenses incurred within the territorial limits of the United States bear to the total expenses incurred in services between the United States and foreign countries. For ships the average should be determined upon a daily basis for each ship and the amount to be apportioned for each ship as assets employed within the United States should be computed upon the proportion which the number of days the ship was within the territorial limits of the United States bears to the total number of days the ship was in service during the taxable period. For other assets employed in the transportation business, the average of the assets at the beginning and end of the taxable period ordinarily may be taken, but if the average so obtained does not, by reason of material changes during the taxable year, fairly represent the average for such year either for the assets employed in the transportation business in the United States or in total, the average must be determined upon a monthly or daily basis.

(2) In computing net income from sources within the United States there shall be allowed as deductions from the gross income as determined in accordance with paragraph (1), (*a*), the expenses of the transportation business carried on within the United States as determined under paragraph (1), and (*b*) the expenses determined in accordance with paragraphs (3) and (4).

(3) Interest and income, war-profits, and excess-profits taxes should be excluded from the apportionment process, as explained in paragraph (1); but for the purpose of computing net income there may be deducted from the gross income from sources within the United States, after the amount of such gross income has been determined, a ratable part (*a*) of all interest (deductible under section 23 (b)), and (*b*) of all income, war-profits, and excess-profits taxes (deductible under section 23 (c) and (d)), paid or accrued in respect of the business of transportation service between points in the United

States and points outside the United States. Such ratable part should ordinarily be based upon the ratio of gross income from sources within the United States to the total gross income from such transportation service.

(4) If a foreign corporation subject to this article is also engaged in a business other than that of providing transportation service between points in the United States and points outside the United States, the costs and expenses (including taxes) properly apportioned or allocated to such other business should be excluded both from the deductions and from the apportionment process prescribed in paragraph (1); but, for the purpose of determining net income, a ratable part of any general expenses, losses, or deductions, which can not definitely be allocated to some item or class of gross income, may be deducted from the gross income from sources within the United States after the amount of such gross income has been determined. Such ratable part should ordinarily be based upon the ratio of gross income from sources within the United States to the total gross income.

(5) Application for permission to base the return upon the taxpayer's books of account will be considered by the Commissioner in the case of any taxpayer subject to this article, who, in good faith and unaffected by considerations of tax liability, regularly employs in his books of account a detailed allocation of receipts and expenditures which reflects more clearly than the process prescribed in paragraphs (1)–(4), the income derived from sources within the United States.

ART. 684. **Computation of income.**—Where a taxpayer has gross income from sources within or without the United States as defined by section 119 (a) or (c) together with gross income derived partly from sources within and partly from sources without the United States, the amounts thereof, together with the expenses and investment applicable thereto, shall be segregated, and the net income from sources within the United States shall be separately computed therefrom.

SEC. 120. UNLIMITED DEDUCTION FOR CHARITABLE AND OTHER CONTRIBUTIONS.

In the case of an individual if in the taxable year and in each of the ten preceding taxable years the amount of the contributions or gifts described in section 23 (n) plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of section 23 (n), then the 15 per centum limit imposed by such section shall not be applicable.

SUPPLEMENT C—CREDITS AGAINST TAX

[Supplementary to Subtitle B, Part III]

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(a) **Allowance of credit.**—The tax imposed by this title shall be credited with:

(1) CITIZEN AND DOMESTIC CORPORATION.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and

(2) RESIDENT OF UNITED STATES.—In the case of a resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any possession of the United States; and

(3) ALIEN RESIDENT OF UNITED STATES.—In the case of an alien resident of the United States, the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and

(4) PARTNERSHIPS AND ESTATES.—In the case of any such individual who is a member of a partnership or a beneficiary of an estate or trust, his proportionate share of such taxes of the partnership or the estate or trust paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(b) **Limit on credit.**—In no case shall the amount of credit taken under this section exceed the same proportion of the tax (computed on the basis of the taxpayer's net income without the deduction of any income, war-profits, or excess-profits tax any part of which may be allowed to him as a credit by this section), against which such credit is taken, which the taxpayer's net income (computed without the deduction of any such income, war-profits, or excess-profits tax) from sources without the United States bears to his entire net income (computed without such deduction) for the same taxable year.

(c) **Adjustments on payment of accrued taxes.**—If accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer shall notify the Commissioner, who shall redetermine the amount of the tax for the year or years affected, and the amount of tax due upon such redetermination, if any, shall be paid by the taxpayer upon notice and demand by the collector, or the amount of tax overpaid, if any, shall be credited or refunded to the taxpayer in accordance with the provisions of section 322. In the case of such a tax accrued but not paid, the Commissioner as a condition precedent to the allowance of this credit may require the taxpayer to give a bond with sureties satisfactory to and to be approved by the Commissioner in such sum as the Commissioner may require, conditioned upon the payment by the taxpayer of any

amount of tax found due upon any such redetermination; and the bond herein prescribed shall contain such further conditions as the Commissioner may require.

(d) **Year in which credit taken.**—The credits provided for in this section may, at the option of the taxpayer and irrespective of the method of accounting employed in keeping his books, be taken in the year in which the taxes of the foreign country or the possession of the United States accrued, subject, however, to the conditions prescribed in subsection (c) of this section. If the taxpayer elects to take such credits in the year in which the taxes of the foreign country or the possession of the United States accrued, the credits for all subsequent years shall be taken upon the same basis.

(e) **Proof of credits.**—These credits shall be allowed only if the taxpayer furnishes evidence satisfactory to the Commissioner showing the amount of income derived from sources without the United States, and all other information necessary for the verification and computation of such credits.

(f) **Taxes of foreign subsidiary.**—For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 23 (p)) in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: *Provided*, That the credit allowed to any domestic corporation under this subsection shall in no case exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. The term "accumulated profits" when used in this subsection in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this subsection shall be construed to mean such accounting period.

(g) **Corporations treated as foreign.**—For the purposes of this section the following corporations shall be treated as foreign corporations:

(1) A corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its gross income from sources within a possession of the United States;

(2) A corporation organized under the China Trade Act, 1922, and entitled to the credit provided for in section 261.

ART. 691. **Analysis of credit for taxes.**—(1) In the case of a citizen of the United States, whether resident or nonresident, and in the case of a domestic corporation the basis of the credit for taxes is as follows: (*a*) The amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and (*b*) an individual's proportionate share of any such taxes of a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued during the taxable year to a foreign country or to any possession of the United States, as the case may be.

(2) In the case of an alien resident of the United States the basis of the credit for taxes is as follows: (*a*) The amount of any such taxes paid or accrued during the taxable year to any possession of the United States; (*b*) the amount of any such taxes paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country; and (*c*) his proportionate share of any such taxes of a partnership of which he is a partner or of an estate or trust of which he is a beneficiary paid or accrued during the taxable year to any foreign country, if the foreign country of which such alien resident is a citizen or subject, in imposing such taxes, allows a similar credit to citizens of the United States residing in such country, or to any possession of the United States, as the case may be. A citizen of the United States or a domestic corporation entitled to the benefits of section 251, or a China Trade Act corporation, is not allowed any of the credits provided by section 131.

ART. 692. **Meaning of terms.**—The "amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the taxpayer claiming credit. "Foreign country" includes within its meaning any foreign sovereign state or self-governing colony (for example, the Dominion of Canada), but does not include a foreign municipality (for example, Montreal) unless itself a sovereign state (for example, Hamburg). "Any possession of the United States" includes, among others, Porto Rico, the Philippines, and the Virgin Islands. But see section 251 and article 1132. As to the meaning of "sources," see section 119. (See also section 701.)

ART. 693. **Conditions of allowance of credit.**—When credit is sought for income, war-profits, or excess-profits taxes paid other than to the United States, the income tax return must be accompanied by Form 1116 in the case of an individual, and by Form 1118 in the case of a corporation. The form must be carefully filled in with all the information there called for and with the calculations of credits there indicated, and must be duly signed and sworn to or affirmed. When credit is sought for taxes already paid the form must have attached to it the receipt for each such tax payment. When credit is sought for taxes accrued, the form must have attached to it the return on which each such accrued tax was based. This receipt or return so attached must be either the original, a duplicate original, a duly certified or authenticated copy, or a sworn copy. In case only a sworn copy of a receipt or return is attached, there must be kept readily available for comparison on request the original, a duplicate original, or a duly certified or authenticated copy. Where the receipt or the return is in a foreign language, a certified translation thereof must be furnished by the taxpayer.

In the case of a credit sought for a tax accrued but not paid, the Commissioner may require as a condition precedent to the allowance of credit a bond from the taxpayer in addition to Form 1116 or 1118. If such a bond is required, Form 1117 shall be used by an individual and Form 1119 by a corporation. It shall be in such sum as the Commissioner may prescribe, and shall be conditioned for the payment by the taxpayer of any amount of tax found due upon any redetermination of the tax made necessary by such credit proving incorrect, with such further conditions as the Commissioner may require. This bond shall be executed by the taxpayer, or the agent or representative of the taxpayer, as principal, and by sureties satisfactory to and approved by the Commissioner. (See also section 1126 of the Revenue Act of 1926.)

For credit where taxes are paid by a foreign corporation controlled by a domestic corporation, see article 698. A claim for credit in such a case is also to be made on Form 1118. See article 697 with reference to the option granted by section 131 (d).

ART. 694. **Redetermination of tax when credit proves incorrect.**—In case credit has been given for taxes accrued, or a proportionate share thereof, and the amount that is actually paid on account of such taxes, or a proportionate share thereof, is not the same as the amount of such credit, or in case any tax payment credited is refunded in whole or in part, the taxpayer shall immediately notify the Commissioner. The Commissioner will thereupon redetermine the amount

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of the income tax of such taxpayer for the year or years for which such incorrect credit was granted. The amount of tax, if any, due upon such redetermination shall be paid by the taxpayer upon notice and demand by the collector. The amount of tax, if any, shown by such redetermination to have been overpaid shall be credited or refunded to the taxpayer in accordance with the provisions of section 322. (See articles 1251–1257.)

ART. 695. **Countries which do or do not satisfy the similar credit requirement.**—(*a*) The following is an incomplete list of the countries which satisfy the similar credit requirement of section 131 (a) (3) of the Revenue Act of 1928, either by allowing to citizens of the United States residing in such countries a credit for the amount of income taxes paid to the United States, or, in imposing such taxes, by exempting from taxation the incomes received from sources within the United States by citizens of the United States residing in such countries: Australia, Austria, Bulgaria, Canada, Italy, Netherlands, Newfoundland, Salvador.

(*b*) The following is an incomplete list of the countries which do not satisfy the similar credit requirement of section 131 (a) (3) of the Revenue Act of 1928, either because such countries do not allow any credit to citizens of the United States residing in such countries for the amount of income taxes paid to the United States, or because such countries do not impose any income taxes: Argentina, Bahama, Belgium, Bermuda, Bolivia, Bosnia, Brazil, Chile, China, Costa Rica, Czechoslovakia, Dutch Guiana, Ecuador, Egypt, Finland, France, Germany, Great Britain and Northern Ireland, Guatemala, Herzegovina, India, Irish Free State, Jamaica, Japan, Montenegro, Morocco, New Zealand, Nicaragua, Panama, Paraguay, Persia, Peru, Portugal, Rumania, Santo Domingo, Serbia, Siam, Straits Settlements, Sweden, Switzerland, Venezuela.

The former names of certain of these territories are here used for convenience in spite of the actual or possible change in the name or sovereignty. A resident of the United States who is a citizen or subject of any country in the first list is entitled, for the purpose of the total tax due the United States for 1928 and subsequent years, to a credit for the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country. If he is a citizen or subject of any country in the second list, he is not entitled to such credit. If he is a citizen or subject of a country which is in neither list, then to secure the desired credit he must prove to the satisfaction of the Commissioner that his country satisfies the similar credit requirement of the Act.

ART. 696. **Limitation of credit for taxes.**—The amount allowable as a credit against the income tax under Title I is limited by section 131 (b) to a sum not in excess of the same proportion of the tax (computed upon the basis of the taxpayer's net income without deducting any income or profits taxes, any part of which may be allowed as a credit under section 131) against which the credit is taken, which the taxpayer's net income (computed without deduction for such income and profits taxes) from sources without the United States bears to the taxpayer's entire net income (computed without such deduction) for the same taxable year. The operation of this limitation in the case of a citizen of the United States having $20,000 earned net income from sources within the United States within the meaning of section 31 and entitled to an exemption of $1,500 is illustrated as follows:

Income from sources within the United States	$50,000.00
Income from sources without the United States	25,000.00
Total net income (without deduction of income and profits taxes paid or accrued to foreign countries or possessions of the United States)	75,000.00
United States income tax on $75,000	10,183.75
Foreign income and profits taxes upon $25,000	5,000.00
Amount which may be credited against the United States tax $\frac{25000}{75000}$ of $10,183.75	3,394.58

ART. 697. **When credit for taxes may be taken.**—The credit for taxes provided by section 131 (a) may ordinarily be taken either in the return for the year in which the taxes accrued or in which the taxes were paid, dependent upon whether the accounts of the taxpayer are kept and his returns filed upon the accrual basis or upon the cash receipts and disbursements basis. Section 131 (d) allows the taxpayer, at his option and irrespective of the method of accounting employed in keeping his books, to take such credit for taxes as may be allowable in the return for the year in which the taxes accrued. An election thus made under this section or under section 222 (c) or 238 (c) of the Revenue Act of 1924 or 1926 must be followed in returns for all subsequent years.

ART. 698.[1] **Domestic corporation owning a majority of the stock of foreign corporation.**—A domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 23 (p)) in any taxable year, shall be entitled to credit against the amount of its income tax, the same proportion of the sum of any income, war-profits, or excess-profits taxes paid or accrued by such foreign corporation to any

[1] See T. D. 4323, p. 361.

foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. But in no case shall such credit exceed the same proportion of the taxes against which it is credited, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. A domestic corporation seeking such credit must comply with the provisions of article 693 applicable to credits for taxes already paid, except that the form to be used is Form 1118 instead of Form 1116.

SEC. 132. PAYMENTS UNDER 1926 ACT.

Any amount paid before or after the enactment of this Act on account of the tax imposed for a fiscal year beginning in 1927 and ending in 1928 by Title II of the Revenue Act of 1926 shall be credited toward the payment of the tax imposed for such fiscal year by this Act, and if the amount so paid exceeds the amount of such tax imposed by this Act, the excess shall be credited or refunded in accordance with the provisions of section 322.

SUPPLEMENT D—RETURNS AND PAYMENT OF TAX

[Supplementary to Subtitle B, Part V]

SEC. 141. CONSOLIDATED RETURNS OF CORPORATIONS—1929 AND SUBSEQUENT TAXABLE YEARS.

(a) **Privilege to file consolidated returns.**—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(b) **Regulations.**—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

(c) **Computation and payment of tax.**—In any case in which a consolidated return is made the tax shall be determined, computed,

assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the date on which such return is made. Only one specific credit, computed as provided in section 26 (b), shall be allowed in computing the tax.

(d) **Definition of "affiliated group."**—As used in this section an "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 per centum of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per centum of the stock of at least one of the other corporations.

As used in this subsection the term "stock" does not include non-voting stock which is limited and preferred as to dividends.

(e) A consolidated return shall be made only for the domestic corporations within the affiliated group. An insurance company subject to the tax imposed by section 201 or 204 shall not be included in the same consolidated return with a corporation subject to the tax imposed by section 13.

(f) **China Trade Act corporations.**—A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(g) **Corporations deriving income from possessions of United States.**—For the purposes of this section a corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its income from possessions of the United States, shall be treated as a foreign corporation.

(h) **Subsidiary formed to comply with foreign law.**—In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per centum of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this title as a domestic corporation.

(i) **Suspension of running of statute of limitations.**—If a notice under section 272 (a) in respect of a deficiency for any taxable year is mailed to a corporation, the suspension of the running of the statute of limitations, provided in section 277, shall apply in the case of corporations with which such corporation made a consolidated return for such taxable year.

(j) **Allocation of income and deductions.**—For allocation of income and deductions of related trades or businesses, see section 45.

ART. 711. **Consolidated returns of affiliated corporations for 1929 and subsequent taxable years.**—The regulations prescribed under section 141 (b), and applicable to the making of consolidated returns by affiliated corporations for the taxable year 1929 and subsequent taxable years, and to the determination, computation, assessment, collection, and adjustment of tax liabilities under consolidated returns for

such years, have been promulgated as Regulations 75. For convenience, Regulations 75 are reprinted in the appendix to these regulations. For definition of taxable year, see section 48.

ART. 712. **Formation of and changes in affiliated group.**—An affiliated group of corporations, within the meaning of section 141, is formed at the time that the common parent corporation becomes the owner directly of at least 95 per cent of the stock (as defined by section 141 (d)) of another corporation. A corporation becomes a member of an affiliated group at the time that one or more members of the group become the owners directly of at least 95 per cent of its stock. A corporation ceases to be a member of an affiliated group at the time that the aggregate of its stock owned directly by the members of the group becomes less than 95 per cent.

ART. 713. **Corporations to be included in consolidated returns for 1929 and subsequent taxable years.**—A consolidated return must include every domestic corporation which is a member of the affiliated group; but shall not include a foreign corporation (except as provided in section 141 (h) and article 714); a corporation organized under the China Trade Act, 1922; a corporation entitled to the benefits of section 251; or an insurance company subject to the tax imposed by section 201 or 204, in the case of a consolidated return for corporations subject to the tax imposed by section 13; or a corporation subject to the tax imposed by section 13, in the case of a consolidated return for insurance companies subject to the tax imposed by section 201 or 204.

ART. 714. **Foreign corporations which may be treated as domestic corporations.**—In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per cent of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of Canada or of Mexico and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for income tax purposes for 1928 and subsequent taxable years as a domestic corporation. The option to treat such foreign corporation as a domestic corporation so that it may be included in a consolidated return must be exercised at the time of making the consolidated return.

ART. 715. **Allowance of specific credit.**—Only one specific credit of $3,000 (see section 26 (b) and article 301) shall be allowed against the consolidated net income of an affiliated group which makes a consolidated return, and this only in case the consolidated net income of the group does not exceed $25,000. If the consolidated net income of the group is more than $25,000, the tax imposed by section 13,

201, or 204 shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000. In cases where a consolidated return is made by an affiliated group for a fractional part of a year, the provisions of section 47 and article 371 are applicable. If the separate return of a corporation becoming a member or ceasing to be a member of an affiliated group making a consolidated return is made for a period of less than 12 months, such return is for a fractional part of a year within the meaning of section 47 (e), and the specific credit of $3,000, if allowable, shall be reduced as therein provided. (See article 371.)

SEC. 142. CONSOLIDATED RETURNS OF CORPORATIONS—TAXABLE YEAR 1928.

(a) Consolidated returns permitted.—Corporations which are affiliated within the meaning of this section may, for the taxable year 1928, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return for the taxable year 1927 was made upon either of such bases, return for the taxable year 1928 shall be upon the same basis unless permission to change the basis is granted by the Commissioner.

(b) Computation and payment of tax.—In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as provided in section 26 (b).

(c) Definition of affiliation.—For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per centum of the stock of the other or others, or (2) if at least 95 per centum of the stock of two or more corporations is owned by the same interests. As used in this subsection the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(d) China Trade Act corporations.—A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(e) Corporations deriving income from possessions of United States.—For the purposes of this section a corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its income from possessions of the United States, shall be treated as a foreign corporation.

(f) Suspension of running of statute of limitations.—If a notice under section 272 (a) in respect of a deficiency for the taxable year

1928 is mailed to a corporation, the suspension of the running of the statute of limitations, provided in section 277, shall apply in the case of corporations with which such corporation made a consolidated return for such taxable year.

(g) **Allocation of income and deductions.**—For allocation of income and deductions of related trades or businesses, see section 45.

ART. 731. **Consolidated returns of affiliated corporations for 1928.**—Affiliated corporations as defined in section 142 (c) may for the taxable year 1928 make separate returns or make a consolidated return in which will be reported the consolidated net income of the affiliated corporations, except that if a return for the taxable year 1927 was properly made upon either of these bases, the return for the taxable year 1928 must be made upon the same basis unless permission to change is granted by the Commissioner. In applying for permission to change from one basis to the other there should be submitted a statement in the form of an affidavit executed by the persons qualified to sign the returns setting forth completely the reasons for making the request. If a consolidated return including all of the affiliated corporations is made, the tax shall be assessed upon the basis of such return, the total tax being computed in the first instance as a unit and assessed against the respective affiliated corporations in such proportions as may be agreed among them, or, in the absence of any such agreement, on the basis of the net income properly assignable to each. If a notice in respect of a deficiency in tax for the taxable year 1928 is mailed to any of the affiliated corporations which made a consolidated return for such taxable year, the running of the statute of limitations on assessment and collection shall be suspended in the case of all of such corporations. (See sections 272 (a) and 277 and articles 1171, 1201, and 1202.)

The consolidated return shall be filed on Form 1120 in the office of the collector of the district in which one of the affiliated corporations has its principal office, except, if the affiliated group of corporations has a parent corporation, the consolidated return shall be filed in the office of the collector of the district in which the parent corporation has its principal office. Each of the other affiliated corporations shall cause to be filed in the office of the collector of its district a statement to the effect that its net income has been reported in the consolidated return, which statement shall designate the district in which the consolidated return is filed. The consolidated return shall be executed by one of the affiliated corporations (in case the affiliated group of corporations has a parent corporation by the parent corporation) on behalf of all the affiliated corporations. It shall be sworn to by the president, vice president, or other principal officer and the

treasurer or assistant treasurer of such corporation. The consolidated return shall include therein a statement setting forth—

(*a*) The name and address of each of the affiliated corporations;

(*b*) The number of shares and the par value of each class of outstanding capital stock of each such corporation at the beginning of the taxable year, together with a detailed description of the rights attaching to each class of stock;

(*c*) The number of shares and the par value of each class of such capital stock owned by the corporation which owns at least 95 per cent of the stock of another corporation or other corporations or by the same interests during the taxable year 1928;

(*d*) In the case of affiliated corporations, the stock of which is owned by the same interests, a list of shareholders of each of such affiliated corporations, with the percentage of each class of the total outstanding stock of each affiliated corporation owned by each of such shareholders during all or any part of the taxable year 1928; and

(*e*) In the event the affiliated corporations agree as to the proportion of the total tax to be assessed upon each affiliated corporation, an agreement in writing showing such apportionment. Unless such agreement accompanies the return, the tax shall be assessed and collected on the basis of the net income properly assignable to each affiliated corporation.

If there are any changes of ownership during the taxable year 1928, the information required under paragraphs (*b*) and (*c*) of this article, should show the conditions existing immediately subsequent to such changes.

Foreign corporations, corporations entitled to the benefits of section 251, and corporations organized under the China Trade Act, 1922, may not make consolidated returns. It is not permissible to include the net income of any such corporation in a consolidated return. But see section 141 (h) and article 714 as to when a foreign corporation may be treated as a domestic corporation for the purpose of making a consolidated return. See section 45 regarding the allocation of income and deductions of related trades or businesses owned or controlled by the same interests. See section 131 (f) and article 698 regarding credit for taxes on account of ownership of stocks of foreign corporations and of corporations entitled to the benefits of section 251 or 261.

ART. 732. **When corporations are affiliated for 1928.**—For the taxable year 1928 two or more domestic corporations will be deemed to be affiliated if one corporation owns at least 95 per cent of all the stock

of the other or others, exclusive of nonvoting stock which is limited and preferred as to dividends, or if at least 95 per cent of the stock of two or more corporations, exclusive of nonvoting stock limited and preferred as to dividends, is owned by the same interests.

ART. 733. **Change in stock ownership during taxable year where consolidated return is made.**—(*a*) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership during the year the affiliated status is terminated, or (*b*) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership shall be submitted to the Commissioner.

Ordinarily in such cases, where only two corporations are involved, the corporations, under the conditions described in (*a*) of the preceding paragraph, should make a consolidated return including the income of both corporations to the date of the change of stock ownership, and each should make a separate return from the date of such change in stock ownership to the end of the taxable period, and, under the conditions described in (*b*) of the preceding paragraph, each corporation should make a separate return from the beginning of the taxable period to the date of the change in stock ownership, and a consolidated return should be made by the corporations from the date of change of stock ownership to the end of the taxable year, including therein the income of both corporations for such period.

Where there are more than two corporations affiliated at the beginning of the taxable year, and due to a change in stock ownership the affiliated status of one or more is terminated, but there remain at least two corporations affiliated during the entire year, the corporations should make a consolidated return for the entire year, excluding from the return the income of the corporations whose affiliated status is terminated, from the date of the change in stock ownership; or where two or more corporations are affiliated at the beginning of the taxable year, and through change in stock ownership additional corporations become affiliated, the corporations should make a consolidated return including the income of the additional corporations from the date of change of stock ownership. In either case, the corporations whose status is changed during the taxable year should make separate returns for that part of the taxable year during which they were not affiliated.

Where, in accordance with the procedure set forth in the preceding paragraphs, a return is made by a corporation for a period of less than a year, the tax shall be computed in accordance with section 47 and article 371. Where corporations become affiliated during the taxable year, the separate returns of the corporations for the portion of the taxable year during which they were not affiliated will not be due until the fifteenth day of the third month following the close of the taxable year. For example, if two corporations become affiliated on July 1, 1928, and make a consolidated return for the period from July 1 to December 31, 1928, the separate returns of the corporations covering the period from January 1 to June 30, 1928, will be due on March 15, 1929. In any case in which the change of affiliated status is for a period so short as to be negligible, a consolidated return or separate returns for the entire period, as the case may be, may be made; in such cases, however, there should accompany the return a complete statement setting forth the changes in the affiliated status occurring during the taxable year.

ART. 734. **Consolidated net income of affiliated corporations for 1928.**—Subject to the provisions covering the determination of taxable net income of separate corporations, and subject further to the elimination of intercompany transactions (whether or not resulting in any profit or loss to the separate corporations), the consolidated taxable net income shall be the combined net income of the several affiliated corporations. Only one specific credit of $3,000 (see section 26 (b) and article 301) shall be allowed against the consolidated net income of the affiliated corporations, and this only in case the consolidated net income does not exceed $25,000; but if such net income is more than $25,000, the tax imposed by section 13, 201, or 204 shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000. In respect of the statement of gross income and deductions and the several schedules required in connection with a consolidated income tax return, the corporations making such return are required to prepare and file such statement and schedules in columnar form to the end that the details of the items of gross income and deductions for each corporation included in the consolidation may be readily audited.

ART. 735. **Taxable year of affiliated corporations making consolidated return.**—In the case of a consolidated return of affiliated corporations, the consolidated net income must be computed on the basis of the taxable year (calendar year or fiscal year) of any one of the affiliated corporations, except, if the affiliated group of corporations has a parent corporation, the consolidated net income must be computed upon the basis of the taxable year of the parent corporation. However, if the corporations properly made a consolidated return for the taxable year 1927, the consolidated net income for the taxable year 1928 must be computed on the basis of the same taxable year upon which the 1927 return was made, unless permission to change is

granted by the Commissioner. If pursuant to this article the taxable year of a group of corporations affiliated under the provisions of section 142 (c) (2) would be a fiscal year beginning in 1928, a consolidated return for a fractional part of a year may be filed by such affiliated corporations for the period between the close of the previous fiscal year of the group and December 31, 1928. In such cases the period beginning January 1, 1929, shall be included in the return or returns for the taxable year 1929.

SEC. 143. FIDUCIARY RETURNS.

(a) **Requirement of return.**—Every fiduciary (except a receiver appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for any of the following individuals, estates, or trusts for which he acts, stating specifically the items of gross income thereof and the deductions and credits allowed under this title—

(1) Every individual having a net income for the taxable year of $1,500 or over, if single, or if married and not living with husband or wife;

(2) Every individual having a net income for the taxable year of $3,500 or over, if married and living with husband or wife;

(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income;

(4) Every estate or trust the net income of which for the taxable year is $1,500 or over;

(5) Every estate or trust the gross income of which for the taxable year is $5,000 or over, regardless of the amount of the net income; and

(6) Every estate or trust of which any beneficiary is a nonresident alien.

(b) **Joint fiduciaries.**—Under such regulations as the Commissioner with the approval of the Secretary may prescribe a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be sufficient compliance with the above requirement. Such fiduciary shall make oath (1) that he has sufficient knowledge of the affairs of the individual, estate or trust for which the return is made, to enable him to make the return, and (2) that the return is, to the best of his knowledge and belief, true and correct.

(c) **Law applicable to fiduciaries.**—Any fiduciary required to make a return under this title shall be subject to all the provisions of law which apply to individuals.

ART. 741. **Fiduciary returns.**—Every fiduciary, or at least one of joint fiduciaries, must make a return of income—

(*a*) For the individual whose income is in his charge, if the gross income of such individual is $5,000 or over, or if the net income of such individual is $1,500 or over if single or if married and not living with husband or wife, or if such individual is married and

was living with husband or wife for the entire taxable year and the aggregate gross income of both husband and wife is $5,000 or over, or the aggregate net income of both husband and wife is $3,500 or over, or if such individual is married and was living with husband or wife for a period less than the entire taxable year and the aggregate gross income of both husband and wife is $5,000 or over, or the aggregate net income of both husband and wife is equal to, or in excess of, the credit allowed them by section 25 (e) (2), or

(*b*) For the estate or trust for which he acts if the net income of such estate or trust is $1,500 or over, or if the gross income of the estate or trust is $5,000 or over, regardless of the amount of the net income, or if any beneficiary of such estate or trust is a nonresident alien.

The return in case (*a*) shall be on Form 1040 or 1040 A. In case (*b*) a return is required on Form 1040 with respect to any taxable net income of the estate or trust computed in accordance with section 162 and a return on Form 1041 with respect to any income deducted under section 162 (b) or (c). If a portion of the income of the estate or trust is retained by the fiduciary and the remainder is distributable or distributed to beneficiaries, both Forms 1040 and 1041 will be required. (See article 862.) See article 745 for returns in cases where any beneficiary is a nonresident alien. If the net income of a decedent from the beginning of the taxable year to the date of his death was $1,500 or more if unmarried, or $3,500 or more if married, or if his gross income for the same period was $5,000 or over, the executor or administrator shall make a return for such decedent. (See article 295.)

As to duties and liabilities of fiduciaries, see further section 312 and article 1241.

ART. 742. **Return by guardian or committee.**—A fiduciary acting as the guardian of a minor having a net income of $1,500 or more, or $3,500 or more, according to the marital status of such person, or having a gross income of $5,000 or over, must make a return for such minor on Form 1040 or 1040 A and pay the tax, unless such minor himself makes a return or causes it to be made. A fiduciary acting as a guardian or the committee of an insane person having an income of $1,500 or more, or $3,500 or more, according to the marital status of such person, or having a gross income of $5,000 or over, must make a return for such incompetent on Form 1040 or 1040 A and pay the tax.

For the purpose of determining the liability of a fiduciary to render a return under the provisions of the preceding paragraph in cases where the minor or the incompetent is married and was living

with husband or wife during the entire taxable year, the aggregate gross income or the aggregate net income of both husband and wife must be taken into consideration. (See article 381.) If the individual for whom the fiduciary is acting as guardian marries during the taxable year, a return must be made if the aggregate gross income of both husband and wife is $5,000 or over, or if the aggregate net income of both husband and wife is equal to, or in excess of, the credit allowed by section 25 (e) (2). (See article 295.)

ART. 743. **Returns where two trusts.**—In the case of two or more trusts the income of which is taxable to the beneficiaries, which were created by the same person and are in charge of the same trustee, the trustee shall make a single return on Form 1041 for all such trusts, notwithstanding that they may arise from different instruments. When, however, a trustee holds trusts created by different persons for the benefit of the same beneficiary, he shall make a return on Form 1041 for each trust separately.

ART. 744. **Return by receiver.**—A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on Form 1040 or 1040 A. When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be made as if by the corporation itself. (See section 52 and articles 391 and 392.) A receiver in charge of the business of a partnership shall render a return on Form 1065. A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common law receivers of all the property or business of an individual or corporation must make returns. (See also sections 148 and 149 (a) and articles 811–831.)

ART. 745. **Return for nonresident alien beneficiary.**—Where a citizen or resident fiduciary has the distribution of the income of a trust any beneficiary of which is a nonresident alien, the fiduciary shall make a return on Form 1040 B for such nonresident alien and pay any tax shown thereon to be due. Unless such return is a true and accurate return of the nonresident alien beneficiary's income from all sources within the United States, the benefits of the credits and deductions to which the beneficiary is entitled can not be obtained in the return filed by the fiduciary. (See sections 215 and 251.) If the beneficiary appoints a person in the United States to act as his agent for the purpose of rendering income tax returns, the fiduciary shall be relieved from the necessity of filing Form 1040 B in behalf of the beneficiary and from paying the tax. In such a case the fiduciary shall make a return on Form 1041 and attach thereto a copy of the notice of appointment. If the sole beneficiary of an estate or trust is a nonresident alien and Form 1040 B is filed by the fiduciary, the filing of Form 1041 will not be required. If there are two or more nonresident alien beneficiaries, the fiduciary shall render a return on Form 1041 and also a return on Form 1040 B for each nonresident alien beneficiary. (See further article 1081.)

ART. 746. **Time for filing return upon death, or termination of trust.**—After his appointment and qualification, an executor or administrator may immediately file a return for the decedent without waiting for the close of the taxable year. Upon the completion of the administration of an estate and final accounting, an executor or administrator may immediately file a return of income of the estate for the taxable year in which the administration was closed. Similarly, upon the termination of a trust, the trustee may immediately make a return without waiting for the close of the taxable year. Any income return required to be filed for a decedent, or for the year in which an estate is closed or a trust terminated, is due on the fifteenth day of the third month following the close of the taxable year during which the decedent dies, the estate is closed, or the trust is terminated, which date shall also be the due date for payment of the tax or the first installment thereof if payment is made under the provisions of section 56 (b). The payment of the tax before the end of the taxable year in such circumstances does not relieve the taxpayer from liability for any additional tax found to be due upon income of the taxable year. (See sections 57 and 272.)

The domiciliary representative is required to include in the return rendered by him as such domiciliary representative the entire income of the estate. Consequently the only return required to be filed by the ancillary representative is on Form 1041, which shall be filed with the collector for his district and shall show the name and address of the domiciliary representative, the amount of gross income received by the ancillary representative, and the deductions to be claimed against such income, including any amount of income properly paid or credited by the ancillary representative to any legatee, heir, or other beneficiary. If the ancillary representative for the estate of a nonresident alien is a citizen or resident of the United States, and the domiciliary representative is a nonresident alien, such ancillary representative is required to render the return otherwise required of the domiciliary representative.

SEC. 144. WITHHOLDING OF TAX AT SOURCE.

(a) Tax-free covenant bonds.—

(1) REQUIREMENT OF WITHHOLDING.—In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, if payable to an individual, a partnership, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein: *Provided*, That if the liability assumed by the obligor does not exceed 2 per centum of the interest, then the deduction and withholding shall, after the date of the enactment of this Act, be at the following rates: (A) 5 per centum in the case of a nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, (B) 12 per centum in the case of such a foreign corporation, and (C) 2 per centum in the case of other individuals and partnerships: *Provided further*, That if the owners of such obligations are not known to the withholding agent the Commissioner may authorize such deduction and withholding to be at the rate of 2 per centum, or, if the liability assumed by the obligor does not exceed 2 per centum of the interest, then at the rate of 5 per centum.

(2) BENEFIT OF CREDITS AGAINST NET INCOME.—Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interest, if he files with the withholding agent on or before February 1 a signed notice in writing claiming the benefit of the credits provided in section 25 (c) and (d); nor in the case of a nonresident alien individual if so provided for in regulations prescribed by the Commissioner under section 215.

(3) WITHHOLDING AT LOWER RATE.—Such deduction and withholding shall be at the rate of 1½ per centum instead of at the rate of 2 per centum in the case of a citizen or resident entitled to receive such interest if he files with the withholding agent on or before February 1 a signed notice in writing that his net income in excess of the credits against net income provided in section 25 does not exceed $4,000.

(4) INCOME OF OBLIGOR AND OBLIGEE.—The obligor shall not be allowed a deduction for the payment of the tax imposed by this title, or any other tax paid pursuant to the tax-free covenant clause, nor shall such tax be included in the gross income of the obligee.

(b) Nonresident aliens.—All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries,

employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment of interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, (other than income received as dividends of the class allowed as a credit by section 25 (a)) shall (except in the cases provided for in subsection (a) of this section and except as otherwise provided in regulations prescribed by the Commissioner under section 215) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 5 per centum thereof: *Provided*, That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

(c) Return and payment.—Every person required to deduct and withhold any tax under this section shall make return thereof on or before March 15 of each year and shall on or before June 15, in lieu of the time prescribed in section 56, pay the tax to the official of the United States Government authorized to receive it. Every such person is hereby made liable for such tax and is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this section.

(d) Income of recipient.—Income upon which any tax is required to be withheld at the source under this section shall be included in the return of the recipient of such income, but any amount of tax so withheld shall be credited against the amount of income tax as computed in such return.

(e) Tax paid by recipient.—If any tax required under this section to be deducted and withheld is paid by the recipient of the income, it shall not be re-collected from the withholding agent; nor in cases in which the tax is so paid shall any penalty be imposed upon or collected from the recipient of the income or the withholding agent for failure to return or pay the same, unless such failure was fraudulent and for the purpose of evading payment.

(f) Refunds and credits.—Where there has been an overpayment of tax under this section any refund or credit made under the provisions of section 322 shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent.

ART. 761. **Withholding tax at source.**—Withholding of a tax of 5 per cent is required in the case of fixed or determinable annual or periodical income paid to a nonresident alien or to a nonresident partnership (see article 1319) composed in whole or in part of nonresident alien individuals, except (1) income from sources without the United States, including interest on deposits with persons carry-

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ing on the banking business paid to persons not engaged in business in the United States and not having any office or place of business therein, (2) dividends of a class allowed as a credit by section 25(a), and (3) interest upon bonds or other obligations of a corporation containing a tax-free covenant. A tax of 5 per cent must be withheld from interest on bonds or securities not containing a tax-free covenant where the owner is unknown to the withholding agent, except where such interest represents income from sources without the United States. For withholding purposes the benefit of the reduced rates of normal tax imposed by section 211(b) upon the compensation of nonresident aliens who are residents of Canada or Mexico may be procured only by filing claim therefor on Form 1115 as provided in article 1072. (See sections 119, 148, 212, 215, 231, 233, 251 (f), and 701 (a) (6) and articles 671–684, 811–818, 1041, 1042, 1071, 1072, 1101, 1102, and 1134.)

A tax of 12 per cent is required to be withheld in the case of fixed or determinable annual or periodical income (with the exceptions stated in the first paragraph of this article) paid after 8 a. m., eastern standard time, May 29, 1928, to a nonresident foreign corporation (see article 1319). (See also section 145 and article 781.)

Withholding of a tax of 2 per cent is required in the case of interest paid to an individual or a partnership, whether resident or nonresident (see article 1319), or to a nonresident foreign corporation upon bonds or other obligations of domestic corporations or resident foreign corporations (see article 1319) containing a tax-free covenant, except that if the liability assumed by the obligor in connection with such a covenant does not exceed 2 per cent of the interest, withholding is required at the rate of 5 per cent in the case of a nonresident alien or a nonresident partnership composed in whole or in part of nonresident alien individuals, and at the rate of 12 per cent in the case of a nonresident foreign corporation. However, withholding is not required in the case of interest payments on such bonds or obligations of a domestic or resident foreign corporation qualifying under section 119 (a) (1) (B), if made to a nonresident alien, to a partnership composed in whole of nonresident aliens, or to a nonresident foreign corporation. A nonresident foreign corporation having a fiscal or paying agent in the United States is required to withhold a tax of 2 per cent upon the interest on its tax-free covenant bonds paid to a citizen or resident of the United States or a partnership any member of which is a citizen or resident. A tax of only 1½ per cent instead of 2 per cent is required to be withheld from interest on tax-free covenant bonds in the case of a citizen or resident if he files with the

withholding agent on or before February 1 a signed notice in writing that his net income in excess of the credits to which he is entitled under section 25 and articles 291–295 does not exceed $4,000. Such notice shall be made on Form 1000. If the owner of bonds or other obligations of a corporation containing a tax-free covenant is unknown to the withholding agent a tax of 2 per cent must be withheld from interest thereon unless the liability assumed by the obligor does not exceed 2 per cent of the interest, in which case withholding must be at the rate of 5 per cent.

Bonds issued under a trust deed containing a tax-free covenant are treated as if they contained such a covenant. Where neither the bonds nor the trust deeds given by the obligor to secure them contain a tax-free covenant, supplemental agreements executed by the obligor corporation and the trustee containing a tax-free covenant which modify the original trust deeds to that extent are of the same effect from the date of their proper execution as if they had been part of the original deeds of trust, and the bonds from such date are subject to the provisions of section 144 (a), provided appropriate authority exists for the modification of the trust deeds in this manner. The authority must be contained in the original trust deeds or actually secured from the bondholders.

A debtor corporation having an issue of bonds or other similar obligations which appoints a duly authorized agent to act in its behalf under the withholding provisions of the Act, is required to file notice of such appointment with the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., giving the name and address of the agent.

Where in connection with the sale of its property, payment of the bonds or other obligations of a corporation is assumed by the assignee, such assignee, whether an individual, partnership, or corporation, must deduct and withhold such taxes as would be required to be withheld by the assignor had no such sale or transfer been made.

A fiduciary is not required to withhold tax and render a withholding return with respect to income of a nonresident alien beneficiary, as a complete return thereof will be included in Form 1040 B. (See articles 745 and 768.)

In the case of corporate bonds or other obligations containing a tax-free covenant, the corporation paying a Federal tax, or any part of it, for some one else pursuant to its agreement is not entitled to deduct such payment from gross income on any ground, nor shall the tax so paid be included in the gross income of the bondholder. The amount of the tax may nevertheless be claimed by the bondholder as a credit against the total amount of tax due in accordance

with section 144 (d). In the case, however, of corporate bonds or obligations containing an appropriate tax-free covenant, the corporation paying for some one else, pursuant to its agreement, a State tax or any tax other than a Federal tax may deduct such payment as interest paid on indebtedness.

ART. 762. **Fixed or determinable annual or periodical income.**—Only fixed or determinable annual or periodical income is subject to withholding. The Act specifically includes in such income, interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. But other kinds of income may be included, as for instance, royalties.

Income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be paid annually if it is paid periodically; that is to say, from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accordance with some one's will or with the happening of an event does not make the payments any the less determinable or periodical. A salesman working by the month for a commission on sales which is paid or credited monthly receives determinable periodical income. The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income.

ART. 763. **Exemption from withholding.**—Withholding from interest on corporate bonds or other obligations containing a tax-free covenant shall not be required in the case of a citizen or resident if he files with the withholding agent when presenting interest coupons for payment, or not later than February 1 following the taxable year, an ownership certificate on Form 1000 stating that his net income does not exceed his personal exemption and other credits allowed by section 25. (See articles 291–295.) To avoid inconvenience a resident alien should file a certificate of residence on Form 1078 with withholding agents, who shall forward such certificates to the Commissioner with a letter of transmittal. (See article 1026.) The income of domestic corporations and of resident foreign corporations is free from withholding. No withholding from corporate dividends is required unless the dividends are treated as income from sources within the United States under section 119 and are distributed by a corporation organized under the China Trade Act, 1922, to—

(*a*) A nonresident alien individual other than a resident of China at the time of such distribution;

(*b*) A nonresident partnership composed in whole or in part of nonresident aliens (other than a partnership resident in China); or

(*c*) A nonresident foreign corporation (other than a corporation resident in China).

In the case of (*a*) and (*b*) the rate of withholding applicable is 5 per cent and in the case of (*c*) 12 per cent. (See further sections 116 (f) and 261.)

ART. 764. **Exemption certificates of nonresident aliens.**—When the gross income of a nonresident alien, which is derived from sources within the United States, does not exceed $10,000 and, exclusive of dividends, is not in excess of the personal exemption of $1,500 (and the credit for dependents in the case of a resident of Canada or Mexico), an exemption certificate, Form 1002, may be executed and filed with the withholding agent, if any part of such gross income is derived from interest upon bonds or similar obligations of a corporation, whether or not such bonds or obligations contain a tax-free covenant.

The withholding agent, upon receipt of the exemption certificates, Form 1002, should make proper record thereof on the retained copies of Form 1012 (see article 768) and forward the exemption certificates with a letter of transmittal to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., where they will be examined. In those cases in which the total income of the bondholder from sources within the United States is found to exceed $10,000, or, exclusive of dividends, to be in excess of the personal exemption (and the credit for dependents in the case of residents of Canada and Mexico), the claim on Form 1002 for the benefit of the personal exemption and such credit will be disallowed. A letter containing a list of the exemption certificates covering the claims disallowed and stating the reason for their disallowance will be mailed to the withholding agent. This letter will also state the portion of the total tax assessed against the withholding agent on the basis of the annual return on Form 1013 (see article 768) to be abated by reason of the exemption certificates covering the claims allowed. A copy of the letter to the withholding agent will be forwarded to the collector of internal revenue as the basis for the acceptance of an amount of tax less than that assessed. No portion of the tax withheld from nonresident aliens should be released on the basis of the exemption certificates, Form 1002, until such letter has been received by the withholding agent. The tax assessed on the basis of the return on Form 1013 less the amount of tax to be abated as shown by the letter to the withholding agent must be paid to the collector on or before June 15. Where

Forms 1002 are received after the tax has been paid, the tax shown to have been overpaid shall be credited or refunded as provided in sections 144 (f) and 322.

The exemption certificate, Form 1002, properly executed, should be filed with the withholding agent at any time after the close of the calendar year, but not later than May 1 of the succeeding year. Notwithstanding the fact that Form 1002 is filed, ownership certificates must be filed as provided in articles 765 and 767.

ART. 765. **Ownership certificates for bond interest.**—The owners (except domestic and resident foreign corporations) of bonds or other obligations containing a tax-free covenant, issued by a domestic corporation, a resident foreign corporation, or a nonresident foreign corporation having a fiscal agent or a paying agent in the United States, when presenting interest coupons for payment shall file an ownership certificate for each issue of bonds, showing the name and address of the debtor corporation, the name and address of the owner of the bonds, a description of the obligations, the amount of interest and its due date, the rate at which tax is to be withheld, and the date upon which the interest coupons were presented for payment. However, ownership certificates need not be filed by a nonresident alien, a partnership composed in whole of nonresident aliens, or a nonresident foreign corporation in connection with interest payments on such bonds or similar obligations of a domestic or resident foreign corporation qualifying under section 119 (a) (1) (B) or of a nonresident foreign corporation. In case of interest on corporate bonds or similar obligations not containing a tax-free covenant, issued by a domestic or resident foreign corporation, other than a corporation qualifying under section 119 (a) (1) (B), ownership certificates are required if the owner of such bonds is a nonresident alien, a nonresident partnership composed in whole or in part of nonresident aliens, or a nonresident foreign corporation. Ownership certificates are required in the case of such bonds, whether or not containing a tax-free covenant, if the owner is unknown to the withholding agent. Ownership certificates need not be filed in the case of interest payments on bonds or similar obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia; or securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or the obligations of the United States or its possessions. (See section 22 (b) (4) and articles 84–88.) Ownership certificates are not required to be filed in connection with interest payments on bonds or similar obligations issued by an individual or a partnership, whether or not such obligations contain a tax-free covenant.

When interest coupons detached from corporate bonds are received unaccompanied by ownership certificates, unless the owner of the bonds is known to the first bank to which the coupons are presented for payment, and the bank is satisfied that the owner is a person who is not required to file an ownership certificate, the bank shall require of the payee a statement showing the name and address of the person from whom the coupons were received by the payee, and alleging that the owner of the bonds is unknown to the payee. Such statement shall be forwarded to the Commissioner with the monthly return on Form 1012. The bank shall also require the payee to prepare a certificate on Form 1001 crossing out "owner" and inserting "payee" and entering the amount of the interest on line 3, and shall stamp or write across the face of the certificate "Statement furnished," adding the name of the bank.

Ownership certificates are required in connection with interest payments on registered bonds as in the case of coupon bonds, except that if ownership certificates are not furnished by the owner of such bonds, ownership certificates must be prepared by the withholding agent.

ART. 766. **Form of certificate for citizens or residents.**—For the purpose of article 765, Form 1000 shall be used by citizens or residents of the United States (individual or fiduciary), resident partnerships, and nonresident partnerships all of the members of which are citizens or residents, in connection with interest payments received on bonds containing a tax-free covenant. If such bonds are issued by a nonresident foreign corporation having a fiscal or paying agent in the United States, Form 1000 should be modified to show the name and address of the fiscal agent or the paying agent in addition to the name and address of the debtor corporation. The amount of interest received on such bonds shall be entered on line 3 of Form 1000, except that in the case of a citizen or resident the interest should be entered on line 2 if the tax to be withheld is at the rate of 1½ per cent as provided in article 761, or on line 1 if the net income does not exceed the personal exemption and other credits allowed by section 25. (See article 763.)

ART. 767. **Form of certificate for nonresident aliens, nonresident foreign corporations, and unknown owners.**—For the purpose of article 765, Form 1001 shall be used in connection with interest payments on bonds, regardless of whether or not such bonds contain a tax-free covenant, (*a*) by nonresident aliens (individual or fiduciary), (*b*) by nonresident partnerships composed in whole or in part of nonresident aliens, (*c*) by nonresident foreign corporations, and (*d*) where the owner is unknown.

ART. 768. **Return and payment of tax withheld.**—Every withholding agent shall make on or before March 15 an annual return on Form 1013 of the tax withheld from interest on corporate bonds or other obligations. This return should be filed with the collector for the district in which the withholding agent is located. The withholding agent shall also make a monthly return on Form 1012 on or before the 20th day of the month following that for which the return is made. The ownership certificates, Forms 1000 and 1001, must be forwarded to the Commissioner with the monthly return. Such of the forms as report interest from which the tax is to be withheld should be listed on the monthly return. While the forms reporting interest from which no tax is to be withheld need not be listed on the return, the number of such forms submitted should be entered in the space provided. Where Form 1000 is modified to show the name and address of a fiscal or paying agent in the United States (see article 766), Forms 1012 and 1013 should be likewise modified.

Every person required to deduct and withhold any tax from income other than such bond interest shall make an annual return thereof to the collector on or before March 15 on Form 1042, showing the amount of tax required to be withheld for each nonresident alien (individual or fiduciary), nonresident partnership composed in whole or in part of nonresident aliens, or nonresident foreign corporation to which income other than bond interest was paid during the previous taxable year. Form 1042 should be filed with the collector for the district in which the withholding agent is located. In every case of both classes the tax withheld must be paid on or before June 15 of each year to the collector. For penalties and additions to the tax attaching upon failure to make such returns or such payment, see sections 146 and 291 and articles 791 and 1211.

ART. 769. **Ownership certificates in the case of fiduciaries and joint owners.**—When fiduciaries have the control and custody of more than one estate or trust, and such estates and trusts have as assets bonds of corporations and other securities, a certificate of ownership shall be executed for each estate or trust, regardless of the fact that the bonds are of the same issue. When bonds are owned jointly by two or more persons, a separate ownership certificate must be executed in behalf of each of the owners.

ART. 770. **Return of income from which tax was withheld.**—The entire amount of the income from which the tax was withheld shall be included in gross income without deduction for such payment of the tax. But any tax so withheld shall be credited against the total tax as computed in the taxpayer's return. If the tax is paid by the recipient of the income or by the withholding agent it shall

not be recollected from the other, regardless of the original liability therefor, and in such event no penalty will be asserted against either person for failure to return or pay the tax where no fraud or purpose to evade payment is involved.

SEC. 145. PAYMENT OF CORPORATION INCOME TAX AT SOURCE.

In the case of foreign corporations subject to taxation under this title not engaged in trade or business within the United States and not having any office or place of business therein, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is provided in section 144 a tax equal to 13½ per centum thereof in respect of all payments of income made before the enactment of this Act, and equal to 12 per centum thereof in respect of all payments of income made after the enactment of this Act, and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section: *Provided*, That in the case of interest described in subsection (a) of that section (relating to tax-free covenant bonds) the deduction and withholding shall be at the rate specified in such subsection.

ART. 781. **Withholding in the case of nonresident foreign corporations.**—In general, with respect to payments to nonresident foreign corporations (see article 1319) withholding is required of a tax of 2 per cent in the case of interest representing income from sources within the United States paid upon corporate bonds or other obligations containing a tax-free covenant except that such withholding is required at the rate of 12 per cent if the liability assumed by the obligor does not exceed 2 per cent of the interest. Withholding of a tax of 12 per cent is also required in the case of payments of other fixed or determinable annual or periodical income from sources within the United States made after the enactment of the Revenue Act of 1928 to nonresident foreign corporations, except corporate dividends other than dividends distributed by a corporation organized under the China Trade Act, 1922, to a nonresident foreign corporation which is not a resident of China. (See also section 144 and articles 761–770.)

As no withholding of tax on bond interest or other income is required in the case of a resident foreign corporation (see article 1319), the person paying such income should be notified by a letter from the corporation that it is not subject to the withholding provisions of the Act. The letter from the corporation shall contain the address of its office or place of business in the United States, and be signed by an officer of the corporation giving his official title. Such letters of notification shall be immediately forwarded by the recipients to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., to be examined.

SEC. 146. PENALTIES.

(a) Any person required under this title to pay any tax, or required by law or regulations made under authority thereof to make a return, keep any records, or supply any information, for the purposes of the computation, assessment, or collection of any tax imposed by this title, who willfully fails to pay such tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than one year, or both, together with the costs of prosecution.

(b) Any person required under this title to collect, account for, and pay over any tax imposed by this title, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

(c) The term "person" as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

ART. 791. **Penalties.**—The penalties provided for in section 146 can not be assessed but are enforceable only by suit or prosecution. For limitations on prosecutions, see the Act of July 5, 1884, as amended by the Revenue Act of 1924 and reenacted without change by section 1110 of the Revenue Act of 1926.

SEC. 147. CLOSING BY COMMISSIONER OF TAXABLE YEAR.

(a) **Tax in jeopardy.**—If the Commissioner finds that a taxpayer designs quickly to depart from the United States or to remove his property therefrom, or to conceal himself or his property therein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax for the taxable year then last past or the taxable year then current unless such proceedings be brought without delay, the Commissioner shall declare the taxable period for such taxpayer immediately terminated and shall cause notice of such finding and declaration to be given the taxpayer, together with a demand for immediate payment of the tax for the taxable period so declared terminated and of the tax for the preceding taxable year or so much of such tax as is unpaid, whether or not the time otherwise allowed by law for filing return and paying the tax has expired; and such taxes shall thereupon become immediately due and payable. In any proceeding in court brought to enforce payment of taxes made due and payable by virtue of the provisions of this section the finding of the Commissioner, made as herein provided, whether made after notice to the taxpayer or not, shall be for all purposes presumptive evidence of the taxpayer's design.

(b) **Security for payment.**—A taxpayer who is not in default in making any return or paying income, war-profits, or excess-profits tax under any Act of Congress may furnish to the United States, under regulations to be prescribed by the Commissioner, with the approval of the Secretary, security approved by the Commissioner that he will duly make the return next thereafter required to be filed and pay the tax next thereafter required to be paid. The Commissioner may approve and accept in like manner security for return and payment of taxes made due and payable by virtue of the provisions of this section, provided the taxpayer has paid in full all other income, war-profits, or excess-profits taxes due from him under any Act of Congress.

(c) **Same—exemption from section.**—If security is approved and accepted pursuant to the provisions of this section and such further or other security with respect to the tax or taxes covered thereby is given as the Commissioner shall from time to time find necessary and require, payment of such taxes shall not be enforced by any proceedings under the provisions of this section prior to the expiration of the time otherwise allowed for paying such respective taxes.

(d) **Citizens.**—In the case of a citizen of the United States or of a possession of the United States about to depart from the United States the Commissioner may, at his discretion, waive any or all of the requirements placed on the taxpayer by this section.

(e) **Departure of alien.**—No alien shall depart from the United States unless he first procures from the collector or agent in charge a certificate that he has complied with all the obligations imposed upon him by the income, war-profits, and excess-profits tax laws.

(f) **Addition to tax.**—If a taxpayer violates or attempts to violate this section there shall, in addition to all other penalties, be added as part of the tax 25 per centum of the total amount of the tax or deficiency in the tax, together with interest at the rate of 1 per centum a month from the time the tax became due.

ART. 801. **Termination of the taxable period by Commissioner.**—Section 147 provides that in the case of a taxpayer who designs by immediate departure from the country or otherwise to avoid the payment of the tax for the preceding or current taxable year, the Commissioner may, upon evidence satisfactory to him, declare the taxable period for such taxpayer immediately terminated and cause the service upon him of a notice and demand for immediate payment of the tax for the taxable period declared terminated, and of the tax for the preceding taxable year, or so much of such tax as is unpaid. In such a case the taxpayer is entitled to the personal exemption and credit for dependents, if otherwise allowable under sections 25, 214, and 251 (see articles 291–295 and 1061), but such personal exemption and credit for dependents shall be reduced proportionately to the length of the period for which the return is made. (See section 47 and article 371.) If suit is necessary to collect a tax made due and payable by the provisions of section 147, the Commissioner's finding

is presumptive evidence of the taxpayer's design. A taxpayer who is not in default in making the returns or in paying other taxes may procure the postponement until the usual time of the payment of taxes which are or may be due pursuant to this article by depositing with the Commissioner United States bonds of a principal amount double the estimated amount of taxes due for the taxable period, or by furnishing such other securities as may be approved by the Commissioner. (See section 1126 of the Revenue Act of 1926.)

Aliens departing from the United States will be required to file returns of income on Form 1040 C and to obtain certificates of compliance with income tax obligations from the collector or revenue agent in charge. A certificate of compliance is attached to and made a part of Form 1040 C. Aliens, whether resident or nonresident, who intend to depart from this country should appear before the collector or revenue agent in charge for the district in which they reside and satisfy all income tax obligations with respect to income received up to and including the calendar month next preceding that of their intended departure. Upon payment of such obligations, or upon satisfactory evidence that no tax is due and payable, the collector or revenue agent in charge will issue a certificate of compliance to the applicant. A properly executed certificate of compliance issued by the collector or revenue agent in charge must be presented at the pier. Aliens presenting themselves at the point of departure without such certificates of compliance will be examined by internal revenue officers at that point, and such taxes as appear to be due and owing will be collected. Citizens of the United States or of possessions of the United States departing from the United States will not be required to procure certificates of compliance or to present any other evidence of compliance with income tax obligations.

If a taxpayer violates or attempts to violate the provisions of section 147, there shall, in addition to all other penalties, be added as a part of the tax 25 per cent of the tax or deficiency in the tax, together with interest at the rate of 1 per cent a month from the time the tax became due.

SEC. 148. INFORMATION AT SOURCE.

(a) Payments of $1,500 or more.—All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another person, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in section 149 (a) or 150), of $1,500 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

(b) Returns regardless of amount of payment.—Such returns may be required, regardless of amounts, (1) in the case of payments of interest upon bonds, mortgages, deeds of trust, or other similar obligations of corporations, and (2) in the case of collections of items (not payable in the United States) of interest upon the bonds of foreign countries and interest upon the bonds of and dividends from foreign corporations by persons undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange.

(c) Recipient to furnish name and address.—When necessary to make effective the provisions of this section the name and address of the recipient of income shall be furnished upon demand of the person paying the income.

(d) Obligations of United States.—The provisions of this section shall not apply to the payment of interest on obligations of the United States.

ART. 811.[1] **Return of information as to payments of $1,500.**—All persons making payment to another person of fixed or determinable income of $1,500 or more in any calendar year must render a return thereof to the Commissioner for such year on or before March 15 of the following year, except as specified in articles 813–815. The return shall be made in each case on Form 1099, accompanied by transmittal Form 1096 showing the number of returns filed. The street and number where the recipient of the payment lives should be stated, if possible. Where no present address is available, the last known post-office address must be given. Although to make necessary a return of information the income must be fixed or determinable, it need not be annual or periodical. (See article 762.)

ART. 812.[1] **Return of information as to payments to employees.**—The names of all employees to whom payments of $1,500 or over a year are made, whether such total sum is made up of wages, salaries, commissions, or compensation in any other form, must be reported. (But see article 813.) Heads of branch offices and subcontractors employing labor, who keep the only complete record of payments therefor, should file returns of information in regard to such payments directly with the Commissioner. When both main office and branch office have adequate records, the return should be filed by the main office. (See article 53.)

[1] See T. D. 4302, p. 362.

ART. 813. **Cases where no return of information required.**—Payments of the following character, although over $1,500, need not be reported in returns of information on Form 1099:

(*a*) Payments of interest on obligations of the United States;

(*b*) Payments by a broker to his customers;

(*c*) Payments of any type made to corporations;

(*d*) Bills paid for merchandise, telegrams, telephone, freight, storage, professional services, and similar charges;

(*e*) Payments of rent made to real estate agents (but the agent must report payments to the landlord if the amount paid during the year was $1,500 or more to a single person, a partnership, or a fiduciary, or $3,500 or more to a married person);

(*f*) Payments made by branches of business houses located in foreign countries to alien employees serving in foreign countries;

(*g*) Payments made by the United States Government to sailors and soldiers and to its civilian employees;

(*h*) Salaries and profits paid or distributed by a partnership to the individual partners; and

(*i*) Payments of salaries, rents, royalties, interest (except bond interest required to be reported on ownership certificates), and other fixed or determinable income aggregating less than $3,500 made to a married individual.

If the marital status of the payee is unknown to the payor, or if the marital status of the payee changed during the taxable year (see article 295), the payee will be considered a single person for the purpose of filing a return of information on Form 1099.

ART. 814. **Return of information as to interest on corporate bonds.**—In the case of payments of interest, regardless of amount, upon bonds and similar obligations of corporations, the ownership certificates, when duly filed, shall constitute and be treated as returns of information.

ART. 815. **Return of information as to payments to other than citizens or residents.**—In the case of payments of fixed or determinable annual or periodical income to nonresident aliens (individual or fiduciary), to nonresident partnerships composed in whole or in part of nonresident aliens, or to nonresident foreign corporations (see article 1319), the returns filed by withholding agents on Form 1042 shall constitute and be treated as returns of information. (See sections 144 and 145 and articles 761–770 and 781.)

ART. 816. **Foreign items.**—The term "foreign item," as used in these regulations, means any item of interest upon the bonds of a foreign country or of a nonresident foreign corporation not having a fiscal or

paying agent in the United States, or any item of dividends upon the stock of such corporation.

ART. 817.[1] **Return of information as to foreign items.**—In the case of foreign items, an information return on Form 1099 is required to be filed by the bank or collecting agent accepting the items for collection, if the foreign item is paid to a citizen or resident of the United States (individual or fiduciary), or a partnership any member of which is a citizen or resident, and if the amount of the foreign items paid in any taxable year to a single person, a partnership, or a fiduciary is $1,500 or more, or to a married person is $3,500 or more. Such forms accompanied by Form 1096 should be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., on or before March 15 of each year. (See article 811.)

ART. 818. **Information as to actual owner.**—When the person receiving a payment falling within the provisions of the Act for information at the source is not the actual owner of the income received, the name and address of the actual owner shall be furnished upon demand of the individual, corporation, or partnership paying the income, and in default of a compliance with such demand the payee becomes liable to the penalties provided. (See section 146.) Dividends on stock are prima facie the income of the record owner of the stock. Upon receipt of dividends by a record owner, he should immediately execute Form 1087 to disclose the name and address of the actual owner. Form 1087 should be filed with the Commissioner of Internal Revenue, Sorting Section, Washington, D. C. Unless such a disclosure is made, the record owner will be held liable for any tax based upon such dividends. (See article 831.)

The filing of Form 1087 is not required (*a*) where stocks are registered in the name of a nominee for a fiduciary required to file a return on Form 1041 in which the dividends from such stocks are reported, and (*b*) where they are owned by a nonresident alien and are registered in the name of a nominee designated by a bank or trust company which is required to file returns of income for such nonresident alien.

SEC. 149. INFORMATION BY CORPORATIONS.

(a) Dividend payments.—Every corporation subject to the tax imposed by this title shall, when required by the Commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each shareholder, the number of shares owned by him, and the amount of dividends paid to him.

(b) Profits of taxable year declared as dividends.—There shall be included in the return or appended thereto a statement of such facts as will enable the Commissioner to determine the portion of the earnings

[1] See T. D. 4302, p. 362.

or profits of the corporation (including gains, profits and income not taxed) accumulated during the taxable year for which the return is made, which have been distributed or ordered to be distributed, respectively, to its shareholders during such year.

(c) **Accumulated gains and profits.**—When requested by the Commissioner, or any collector, every corporation shall forward to him a correct statement of accumulated gains and profits and the names and addresses of the individuals or shareholders who would be entitled to the same if divided or distributed, and of the amounts that would be payable to each.

ART. 831.[1] **Return of information as to payments of dividends.**—When directed by the Commissioner, either specially or by general regulation, every domestic or resident foreign corporation and every nonresident foreign corporation (see article 1319) having a fiscal or paying agent in the United States shall render returns on Forms 1096 and 1099 of its payments of dividends and distributions to shareholders for such period as may be specified, stating the name and address of each shareholder, the number and class of shares owned by him, the date and amount of each dividend paid him, and when the surplus out of which it was paid was accumulated. Returns of information (Forms 1096 and 1099) should be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C.

SEC. 150. RETURNS OF BROKERS.

Every person doing business as a broker shall, when required by the Commissioner, render a correct return duly verified under oath, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe, showing the names of customers for whom such person has transacted any business, with such details as to the profits, losses, or other information which the Commissioner may require, as to each of such customers, as will enable the Commissioner to determine whether all income tax due on profits or gains of such customers has been paid.

ART. 841. **Return of information by brokers.**—When directed by the Commissioner, either specially or by general regulation, every person doing business as a broker shall render a return on Form 1100, showing the names and addresses of customers to whom payments were made or for whom business was transacted during the calendar year or other specified period next preceding, and giving the other information called for by the form.

SEC. 151. COLLECTION OF FOREIGN ITEMS.

All persons undertaking as a matter of business or for profit the collection of foreign payments of interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner and shall be subject to such regulations enabling the

[1] See T. Ds. 4277 and 4305, pp. 363–364.

Government to obtain the information required under this title as the Commissioner, with the approval of the Secretary, shall prescribe; and whoever knowingly undertakes to collect such payments without having obtained a license therefor, or without complying with such regulations, shall be guilty of a misdemeanor and shall be fined not more than $5,000 or imprisoned for not more than one year, or both.

ART. 851. **License to collect foreign items.**—Banks or agents collecting foreign items, as defined in article 816, and required by article 817 to make returns of information with respect thereto, must obtain a license from the Commissioner to engage in such business. Application Form 1017 for such license may be procured from collectors. The license is issued without cost on Form 1010. Any person holding a license under the Revenue Act of 1926 or any prior Act will not be required to renew such license.

SUPPLEMENT E—ESTATES AND TRUSTS

SEC. 161. IMPOSITION OF TAX.

(a) **Application of tax.**—The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) **Computation and payment.**—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor). For return made by beneficiary, see section 143.

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (n)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (n), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the estab-

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lishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

ART. 861. **Estates and trusts.**—In general, the income of a trust for the taxable year which is to be distributed to the beneficiaries must be returned by and will be taxed to the respective beneficiaries, but the income of a trust which is to be accumulated or held for future distribution, whether consisting of ordinary income or gain from the sale of assets included in the corpus of the trust, must be returned by and will be taxed to the trustee. The exception to this general rule is with respect to the income of a trust revocable by the grantor, and the income of a trust which may be distributed to the grantor or used to pay the premiums upon policies of insurance on his life, which income, whether or not distributed, must be returned by and will be taxed to the grantor of the trust. (See section 167 and article 881.)

See section 143 and articles 741–746 with reference to fiduciary returns, and section 24 and articles 281–284 with reference to items not deductible. (See also article 154.)

ART. 862. **Method of computation of net income and tax.**—The Act provides that the tax computed upon the net income of the estate or trust shall be paid by the fiduciary, except as provided in sections 166 and 167. (See article 881.) However, in computing the net income of the estate or trust, the following deductions will be allowed either in addition to, or in lieu of (as the case may be), those specified in sections 23, 119, 213, and 251 in the case of individuals:

(1) If the terms of the will or of the deed creating the trust direct that any part of the gross income of the estate or trust (*a*) be paid or permanently set aside for charitable or other purposes, as specified in section 23 (n), or (*b*) be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit, such gross income so paid or set aside during the taxable year shall be allowed as a deduction in lieu of the deduction authorized by section 23 (n).

(2) The amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, shall be allowed as an additional deduction in computing the net income of the estate or trust. The amount so allowed as a deduction must be included by the beneficiaries in computing their net income, whether distributed to them or not. If the taxable year of the beneficiary differs from that of the estate or trust, the amount which he is required to include in computing his net income shall be based upon the income of the estate or trust for its taxable year ending within his taxable year. The amounts which are allowed as a deduction under this paragraph shall not be allowed as a deduction under paragraph (3) of this article in any taxable year.

(3) Income received by the estate of a deceased person during the period of administration or settlement of the estate, and income of a trust which may in the discretion of the fiduciary be either distributed to the beneficiary or accumulated, is allowable as an additional deduction in computing the net income of the estate or trust for its taxable year to the amount thereof properly paid or credited during such year to any legatee, heir, or beneficiary. Any amount so allowed as a deduction shall be included by a legatee, heir, or beneficiary in computing his net income.

ART. 863. **Decedent's estate during administration.**—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties

of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. But see section 44 (d) and article 355. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its value at the death of the decedent, the excess is income, or may be capital gain, taxable to the estate. (See article 596.) An allowance paid a widow out of the corpus of the estate is not deductible from gross income. Where real estate is sold by the devisee or heir thereof, whether before or after settlement of the estate, he is taxable individually on any profit derived.

ART. 864. **Incidence of tax on estate or trust.**—Liability for payment of the tax attaches to the person of an executor or administrator up to and after his discharge, where prior to distribution and discharge he had notice of his tax obligations or failed to exercise due diligence in determining whether or not such obligations existed. Liability for the tax also follows the estate itself, and when the estate has been distributed, the heirs, devisees, legatees, and distributees may be required to discharge the amount of the tax due and unpaid, to the extent of any share received. (See section 311 and article 1231.) The same considerations apply to other trusts. Where the tax has been paid on the net income of an estate or trust by the fiduciary, the net income on which the tax is paid is free from tax when distributed to the beneficiaries.

SEC. 163. CREDITS AGAINST NET INCOME.

(a) Credits of estate or trust.—For the purpose of the normal tax the estate or trust shall be allowed the same personal exemption as is allowed to a single person under section 25 (c), and, if no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, then in addition the same credits against net income for dividends and interest as are allowed by section 25 (a) and (b).

(b) Credits of beneficiary.—If any part of the income of an estate or trust is included in computing the net income of any legatee, heir, or beneficiary, such legatee, heir, or beneficiary shall, for the purpose of the normal tax, be allowed as credits against net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts of dividends and interest specified in section 25 (a) and (b) as are, under this Supplement, required to be included in computing his net income. Any remaining portion of such amounts specified in section 25 (a) and (b) shall, for the purpose of the normal tax, be allowed as credits to the estate or trust.

ART. 871. **Credits to estate, trust, or beneficiary.**—(*a*) An estate or a trust is allowed the same credits against net income as are single persons, including a personal exemption of $1,500 but no credit for dependents.

(*b*) If no part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, the estate or trust shall be allowed the credits provided in section 25 (a) and (b), in respect of certain dividends, and of interest upon certain obligations of the United States.

(*c*) If any part of the income of the estate or trust is included in computing the net income of any legatee, heir, or beneficiary, he is allowed for the purpose of the normal tax, in addition to his individual credits, the proportionate share of such dividends specified in section 25 (a) and article 291 and of such interest not entirely exempt from tax upon obligations of the United States, as he is required to include in computing his net income. Any remaining portion of such dividends and interest will be allowed as a credit for the purpose of the normal tax to the estate or trust. Where the amount of the dividends and interest specified in section 25 (a) and (b) is in excess of the net income of the estate or trust, the proportionate share of such dividends and interest which each beneficiary is required to include in computing his net income and for which he is allowed a credit for normal tax purposes is an amount equal to his distributive share of the net income of the estate or trust. Each beneficiary is entitled to but one personal exemption, no matter from how many trusts he may receive income. (See section 25 and articles 291–295.)

SEC. 164. DIFFERENT TAXABLE YEARS.

If the taxable year of a beneficiary is different from that of the estate or trust, the amount which he is required, under section 162 (b), to include in computing his net income, shall be based upon the income of the estate or trust for any taxable year of the estate or trust ending within his taxable year.

SEC. 165. EMPLOYEES' TRUSTS.

A trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under section 161, but the amount contributed to such fund by the employer and all earnings of such fund shall be taxed to the distributee in the year in which distributed or made available to him. Such distributees shall for the purpose of the normal tax be allowed as credits against net income such

part of the amount so distributed or made available as represents the items of dividends and interest specified in section 25 (a) and (b).

SEC. 166. REVOCABLE TRUSTS.

Where the grantor of a trust has, at any time during the taxable year, either alone or in conjunction with any person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, then the income of such part of the trust for such taxable year shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

Where any part of the income of a trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him, or where any part of the income of a trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (n), relating to the so-called "charitable contribution" deduction), such part of the income of the trust shall be included in computing the net income of the grantor.

ART. 881. **Income of trusts taxable to grantor.**—In the case of certain trusts which are in whole or in part subject to revocation by the grantor, or which are for the benefit of the grantor, the income of the trust is to be included in computing the net income of the grantor. The income of such trusts must be so included, whether or not the trust was created before the enactment of the Revenue Act of 1928. The cases in which the income of the trust is to be included, in whole or in part, in computing the net income of the grantor are as follows:

(1) Where the grantor of the trust has, at any time during the taxable year, either alone or in conjunction with a person not a beneficiary of the trust, the power to revest in himself title to any part of the corpus of the trust, the income of such part of the trust for that taxable year shall be included in computing the net income of the grantor. The grantor shall include in his income the entire gross income of such part of the trust, and shall be entitled to such deductions with reference to such income as he would have been entitled to if the trust had not been created. Where the grantor relinquishes during the taxable year his power to revest in himself title to the corpus of the trust, the income of the trust shall be taxable to the grantor only for the period during which he had such power.

(2) Where any part of the income of the trust may, in the discretion of the grantor of the trust, either alone or in conjunction with any person not a beneficiary of the trust, be distributed to the grantor or be held or accumulated for future distribution to him; and

(3) Where any part of the income of the trust is or may be applied to the payment of premiums upon policies of insurance on the life of the grantor, other than policies irrevocably payable for the purposes and in the manner specified in section 23 (n), such part of the income of the trust shall be included in computing the net income of the grantor.

The term "beneficiary" as used in this article includes any person entitled to an interest in the income or the principal of a trust, but does not include one having merely a nominal interest in the income or principal.

SEC. 168. CAPITAL NET GAINS AND LOSSES.

In the case of an estate or trust, or of a beneficiary of an estate or trust, the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the estate or trust, and shall be taxed to the beneficiary or to the estate or trust as provided in this Supplement, but at the rates and in the manner provided in section 101 (a) and (b), relating to capital net gains and losses.

ART. 891. **Capital net gains and losses in the case of estates and trusts.**—Estates or trusts, or the beneficiaries thereof, may elect to be taxed as provided in section 101 with respect to any capital net gain. Where the net income of an estate or trust consists in whole or in part of capital net gain, there shall be attached to the return (upon the request of any beneficiary, or without such request, at the election of the fiduciary of an estate) a statement showing—

(1) All items of capital gain, capital loss, and capital deductions, as provided in article 502, and

(2) The names of the beneficiaries and the amounts of their respective shares in such capital net gain or capital net loss.

SEC. 169. NET LOSSES.

The benefit of the special deduction for net losses allowed by section 117 shall be allowed to an estate or trust under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 170. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as credit against the tax of the beneficiary of an estate or trust to the extent provided in section 131.

SUPPLEMENT F—PARTNERSHIPS

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS.

(a) **General rule.**—There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership for the taxable year. If the taxable year of a partner is different from that of the partnership, the amount so included shall be based upon the income of the partnership for any taxable year of the partnership ending within his taxable year.

(b) **Partnership year embracing calendar years with different laws.**—If a fiscal year of a partnership begins in one calendar year and ends in another calendar year, and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then

(1) the rates for the calendar year during which such fiscal year begins shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year, and

(2) the rates for the calendar year during which such fiscal year ends shall apply to an amount of each partner's share of such partnership net income (determined under the law applicable to such calendar year) equal to the proportion which the part of such fiscal year falling within such calendar year bears to the full fiscal year.

In such cases the part of such income subject to the rates in effect for the most recent calendar year shall be added to the other income of the taxpayer subject to such rates and the resulting amount shall be placed in the lower brackets of the rate schedule applicable to such year, and the part of such income subject to the rates in effect for the next preceding calendar year shall be placed in the next higher brackets of the rate schedule applicable to such year.

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except that the so-called "charitable contribution" deduction provided in section 23 (n) shall not be allowed.

ART. 901. **Partnerships.**—Partnerships as such are not subject to taxation under the Act, but are required to make returns of income. (See section 189 and articles 941 and 942.) Individuals carrying on business in partnership are, however, taxable upon their distributive shares of the net income of such partnership, whether distributed or not, and are required to include such distributive shares in their returns. The net income of the partnership shall be computed in the same manner and on the same basis as the net income of an individual, except that the deduction of contributions or gifts is not permitted, as these are allowable deductions, subject to the limitations provided by section 23 (n), to the respective partners in their individual returns. (See sections 22–24 and 41–47 and

the articles thereunder.) In the case of a partnership closely related to other trades or businesses, see section 45.

ART. 902. **Distributive shares of partners.**—The distributive share of the net income of the partnership which a partner is required to include in his return is his proportionate share of the net income of the partnership, either—

(*a*) For the taxable year upon the basis of which the partner's net income is computed, or

(*b*) If the partner's net income is computed upon the basis of a taxable year different from that upon the basis of which the net income of the partnership is computed, for the taxable year of the partnership ending within the taxable year upon the basis of which the partner's net income is computed.

Amounts earned and distributed to a partner by a partnership after the end of its taxable year and before the end of his corresponding taxable year should be accounted for both by the partnership and by the partner in their returns for their next succeeding taxable years. Where the result of partnership operation is a net loss, the loss will be divisible by the partners in the same proportion as net income would have been divisible (or, if the partnership agreement provides for the division of a loss in a manner different from the division of a gain, in the manner so provided), and may be taken by the individual partners in their returns of income.

ART. 903. **Taxation of partners in partnership with fiscal year ending in 1928.**—If the fiscal year of a partnership began in the calendar year 1927 and ended in the calendar year 1928, the method of computing the taxes of the partners is as follows:

(*a*) The amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1927 is found by determining the net income of the partnership for its entire fiscal year in accordance with the law applicable to the calendar year 1927 (Title II of the Revenue Act of 1926) and the distributive share thereof of each partner, and then taking such proportion of that distributive share as the part of the taxable period falling within the calendar year 1927 bears to the entire taxable period.

(*b*) The amount of each partner's distributive share of the net income of the partnership for such fiscal year attributable to the calendar year 1928 is found by determining the net income of the partnership for its entire fiscal year in accordance with the law applicable to the calendar year 1928 and the distributive share thereof of each partner, and then taking such proportion of that

distributive share as the part of the taxable period falling within the calendar year 1928 bears to the entire taxable period.

The tax upon the amount of each partner's distributive share attributable to the calendar year 1927 shall be determined at the rates applicable to that year under the Revenue Act of 1926, and the tax upon such share attributable to the calendar year 1928 shall be determined at the rates prescribed in the Revenue Act of 1928. The distributive share of the partner which is subject to the rates in effect for 1928 shall be added to the partner's other income which is subject to such rates, and the resulting amount shall be placed in the lower brackets of the rate schedule applicable to 1928. The distributive share of the partner subject to the rates in effect in 1927 shall be placed in the next higher brackets of the rate schedule applicable to 1927.

SEC. 184. CREDITS AGAINST NET INCOME.

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts of dividends and interest specified in section 25 (a) and (b) as are received by the partnership.

ART. 911. **Credits allowed partners.**—In addition to the credits ordinarily allowed to an individual, a partner is entitled to a credit against net income for the purpose of the normal tax only of a proportionate share of such dividends specified in section 25 (a) and article 291 and of such interest not entirely exempt from tax upon obligations of the United States as are received by the partnership. There shall be included in the return of the partnership a statement of the amounts of such dividends and interest and the proportionate share thereof of each partner.

SEC. 185. EARNED INCOME.

In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement.

ART. 921. **Earned income credit of partners.**—The earned income credit will be allowed to the members of a partnership with respect to the share of the net income belonging to each which consists of earned income, subject however to the limitation provided by section 31 (b). There must be included in the return of the partnership a statement showing—

(1) The amount of earned income as defined in section 31 and article 312, and

(2) The names of the members and the amounts of their respective shares of earned income. (See article 942.)

SEC. 186. CAPITAL NET GAINS AND LOSSES.

In the case of the members of a partnership the proper part of each share of the net income which consists, respectively, of ordinary net income, capital net gain, or capital net loss, shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary, and shall be separately shown in the return of the partnership and shall be taxed to the member as provided in this Supplement, but at the rates and in the manner provided in section 101 (a) and (b), relating to capital net gains and losses.

ART. 931. **Capital net gains and losses in the case of partnerships.**—Members of a partnership may, with respect to any capital net gain, elect to be taxed as provided in section 101 (a). Where the net income of a partnership consists in whole or in part of capital net gain, there shall be attached to the return (upon the request of any member) a statement showing—

(1) All items of capital gain, capital loss, and capital deductions, as provided in article 502, and

(2) The names of the members and the amounts of their respective shares in such capital net gain or capital net loss.

SEC. 187. NET LOSSES.

The benefit of the special deduction for net losses allowed by section 117 shall be allowed to the members of a partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 188. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

SEC. 189. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this title, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

ART. 941. **Partnership returns.**—Every partnership must make a return of income, regardless of the amount of its net income. The return shall be on Form 1065 and shall be sworn to by one of the partners. Such return shall be made for the taxable year of the partnership, that is, for its annual accounting period (fiscal year or calendar year, as the case may be), irrespective of the taxable years of the partners. (See sections 182 and 183 and articles 901–903.) If the partnership makes any change in its accounting period, it shall make its return in accordance with the provisions of section 47 and article 371. (See also article 744.)

ART. 942. **Contents of partnership return.**—The return of a partnership shall state specifically—

(*a*) The items of its gross income enumerated in section 22;

(*b*) The deductions enumerated in sections 23 and 213, other than the deduction provided in sections 23 (n) and 213 (c);

(*c*) The amounts specified in section 25 (a) and (b) received by the partnership;

(*d*) The amount of any income, war-profits, and excess-profits taxes of the partnership paid during the taxable year to a foreign country or to any possession of the United States, and the amount of any such taxes accrued but not paid during the taxable year;

(*e*) The names and addresses of the individuals who would be entitled to share in the net income of the partnership if distributed;

(*f*) The amount of the distributive share of such net income of each such individual;

(*g*) The part of such share of the net income which consists of earned income; and

(*h*) Such other facts as are required by Form 1065.

SUPPLEMENT G—INSURANCE COMPANIES

SEC. 201. TAX ON LIFE INSURANCE COMPANIES.

(a) **Definition.**—When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health, and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

(b) **Rate of tax.**—In lieu of the tax imposed by section 13, there shall be levied, collected, and paid for each taxable year upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, 12 per centum of its net income;

(2) In the case of a foreign life insurance company, 12 per centum of its net income from sources within the United States.

ART. 951. **Life insurance companies.**—Life insurance companies, as defined in section 201 (a), are subject to the tax imposed by section 201 (b), in lieu of the tax imposed by section 13. The rate for 1928 and for subsequent years is 12 per cent, and the net income upon which the tax is imposed differs from the net income of other corporations. Insurance companies are entitled to the benefit of section 117 (net losses) but not of section 101 (capital gains and losses). All provisions of the Act and of these regulations not inconsistent with the specific provisions of sections 201–203 are applicable to the assessment and collection of this tax, and life insurance companies are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. In determining whether an insurance company is a "life insurance company" as defined in section 201, no reserve shall be regarded as held for the fulfillment of life insurance and annuity contracts unless the company is entitled to a deduction from gross income on account thereof under the provisions of section 203 (a) (2) and article 971. As to foreign companies, see section 203 (c) and article 977.

SEC. 202. GROSS INCOME OF LIFE INSURANCE COMPANIES.

(a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) The term "reserve funds required by law" includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

ART. 961. **Gross income of life insurance companies.**—Gross income in the case of life insurance companies means the gross amount of income received from interest, dividends, and rents, and comprises items 25–34 of the income page of the annual statement for life insurance companies (edition of 1920) adopted by the National Convention of Insurance Commissioners and items 23–30 of the income page of the annual statement for miscellaneous stock companies if any other branches of the insurance business are conducted by the company; except that the rental value of the space occupied by the company in its own building or buildings if included in gross income shall be determined according to the provisions of section 203 (b) and article 976. As to "reserve funds required by law," see article 971.

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) General rule.—In the case of a life insurance company the term "net income" means the gross income less—

(1) TAX-FREE INTEREST.—The amount of interest received during the taxable year which under section 22 (b) is exempt from taxation under this title;

(2) RESERVE FUNDS.—An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only;

(3) DIVIDENDS.—The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 251, and other than a corporation organized under the China Trade Act, 1922, or (B) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 119;

(4) RESERVE FOR DIVIDENDS.—An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract;

(5) INVESTMENT EXPENSES.—Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(6) REAL ESTATE EXPENSES.—Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a company upon his interest as shareholder, which are paid by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes;

(7) DEPRECIATION.—A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence;

(8) INTEREST.—All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; and

(9) SPECIFIC EXEMPTION.—In the case of a domestic life insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $3,000; but if the net income is more than $25,000 the tax imposed by section 201 shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(b) Rental value of real estate.—No deduction shall be made under subsection (a) (6) and (7) of this section on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

(c) Foreign life insurance companies.—In the case of a foreign life insurance company the amount of its net income for any taxable year from sources within the United States shall be the same proportion of its net income for the taxable year from sources within and without the United States, which the reserve funds required by law and held by it at the end of the taxable year upon business transacted within the United States is of the reserve funds held by it at the end of the taxable year upon all business transacted.

ART. 971. **Tax-exempt interest and reserve funds.**—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

(1) Interest which is exempted in the case of other taxpayers by section 22 (b) (4) and articles 84–88; and

(2) Four per cent of the mean of the reserve funds held at the beginning and end of the taxable year, without any abatement on account of tax-exempt interest. (See decision of United States Supreme Court in the case of National Life Insurance Co. *v.* United States (277 U. S., 508).) The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance departments when promulgated in

the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7–11 of the liability page of the annual statement for life insurance companies, and items 16–19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered.

ART. 972. **Reserve for deferred dividends.**—The deduction for deferred dividends under section 203 (a) (4) will be based upon item 37 of the liability page of the annual statement for life insurance companies but shall not include any dividend payable during the year immediately following the taxable year.

ART. 973. **Investment expenses.**—If any general expenses are in part assigned to or included in the investment expenses, the total investment expenses (other than taxes and expenses with respect to real estate) allowable as a deduction shall not exceed one-quarter of 1 per cent of the mean of the book value of the invested assets held at

the beginning and end of the taxable year. If there be no allocation of general expenses to investment expenses, the deduction may consist of investment expenses actually paid during the taxable year, in which case an itemized schedule of such expenses must be appended to the return. The invested assets are items 1–6, item 9, and items 10 and 11 (if interest-bearing assets) of the asset page of the annual statement for life insurance companies, and items 1–4, item 7, and items 27–30 (if interest-bearing assets) of the asset page of the annual statement for miscellaneous stock companies. If the method used by any company in ascertaining the investment expenses where there is any allocation of general expenses shall be changed so that a greater deduction is claimed, the company shall file with its return information sufficient to enable the Commissioner to determine the validity of the claim. The maximum allowance of one-quarter of 1 per cent will not be granted unless it is shown to the satisfaction of the Commissioner that such allowance is justified.

ART. 974. **Taxes and expenses with respect to real estate.**—The deduction for taxes and expenses under section 203 (a) (6) comprises items 31 and 32 of the disbursement page of the annual statement for life insurance companies and items 34 and 35 of the disbursement page of the annual statement for miscellaneous stock companies, except as noted below, and any sum included in any other item representing taxes imposed upon a shareholder of the company upon his interest as shareholder which is paid by the company without reimbursement from the shareholder. No deduction shall be allowed, however, for taxes and expenses (and depreciation) upon any real estate owned and occupied in whole or in part by the company except as provided in article 976. Taxes shall not include assessments against local benefits of a kind tending to increase the value of the property assessed, and expenses shall not include any amount paid out for buildings or for permanent improvements and betterments made to increase the value of any property owned by the company.

ART. 975. **Other deductions.**—(1) The deduction allowed by section 203 (a) (3) for dividends received from other corporations is identical with the deduction allowed other corporations by section 23 (p).

(2) The deduction allowed by section 203 (a) (7) for depreciation is identical with that allowed other corporations by section 23 (k). (See articles 201–210.)

(3) The deduction allowed by section 203 (a) (8) for interest on indebtedness is the same as that allowed other corporations by section 23 (b) (see article 141), but this deduction includes item 18 of

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the disbursement page of the annual statement of life insurance companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.

(4) The deduction of $3,000 allowed domestic life insurance companies with net income of $25,000 or less by section 203 (a) (9) is identical with the specific credit allowed other corporations by section 26, and there is the same equalizing provision in the case of incomes slightly in excess of $25,000. (See article 301.)

ART. 976. **Home office properties.**—No deduction shall be made for any taxes, expenses, or depreciation on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall not be less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and other expenses) at the rate of 4 per cent per annum of the book value at the end of the taxable year of the real estate so owned and occupied. For example, if the book value of a parcel of real estate owned and occupied in whole or in part by the company is $1,000,000, the rents received from other tenants $30,000, taxes and expenses $40,000, and depreciation $20,000, the company would have to include in its gross income a sum not less than $70,000 ($40,000 taxes and expenses, plus $20,000 depreciation, minus $30,000 rents from tenants, plus 4 per cent of $1,000,000) as the rental value of the space occupied by it in order to avail itself of the deductions of $40,000 and $20,000. In any case the rents received from other tenants must be included in gross income.

ART. 977. **Foreign life insurance companies.**—Foreign life insurance companies holding reserve funds upon business transacted within the United States are taxed under section 201 (b) (2) upon their net income from sources within the United States. All business transacted by a United States branch or agency of a foreign life insurance company, for which a reserve fund is required by the laws of any State or Territory of the United States or of the District of Columbia, will be regarded as business transacted within the United States. A foreign life insurance company not doing an insurance business within the United States and holding no reserve funds upon business transacted within the United States, but which derives income from sources within the United States as defined in section 119 (see articles 671–684) is subject to the tax imposed by section 13, upon income

derived from sources within the United States. (See sections 231–238 and articles 1101–1121.)

SEC. 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

(a) Imposition of tax.—In lieu of the tax imposed by section 13 of this title, there shall be levied, collected, and paid for each taxable year upon the net income of every insurance company (other than a life or mutual insurance company) a tax as follows:

(1) In the case of such a domestic insurance company, 12 per centum of its net income;

(2) In the case of such a foreign insurance company, 12 per centum of its net income from sources within the United States.

(b) Definition of income, etc.—In the case of an insurance company subject to the tax imposed by this section—

(1) GROSS INCOME.—"Gross income" means the sum of (A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, and (B) gain during the taxable year from the sale or other disposition of property;

(2) NET INCOME.—"Net income" means the gross income as defined in paragraph (1) of this subsection less the deductions allowed by subsection (c) of this section;

(3) INVESTMENT INCOME.—"Investment income" means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows:

To all interest, dividends and rents received during the taxable year, add interest, dividends and rents due and accrued at the end of the taxable year, and deduct all interest, dividends and rents due and accrued at the end of the preceding taxable year;

(4) UNDERWRITING INCOME.—"Underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred;

(5) PREMIUMS EARNED.—"Premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance. To the result so obtained add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year;

(6) LOSSES INCURRED.—"Losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable

year, and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year. To the result so obtained add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year;

(7) EXPENSES INCURRED.—"Expenses incurred" means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows:

To all expenses paid during the taxable year add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the net income subject to the tax imposed by this section there shall be deducted from expenses incurred as defined in this paragraph all expenses incurred which are not allowed as deductions by subsection (c) of this section.

(c) Deductions allowed.—In computing the net income of an insurance company subject to the tax imposed by this section there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 23 (a);

(2) All interest as provided in section 23 (b);

(3) Taxes as provided in section 23 (c);

(4) Losses incurred as defined in subsection (b) (6) of this section;

(5) Losses sustained during the taxable year from the sale or other disposition of property;

(6) Bad debts in the nature of agency balances and bills receivable ascertained to be worthless and charged off within the taxable year;

(7) The amount received as dividends from corporations as provided in section 23 (p);

(8) The amount of interest earned during the taxable year which under section 22 (b) (4) is exempt from taxation under this title, and the amount of interest allowed as a credit under section 26;

(9) A reasonable allowance for the exhaustion, wear and tear of property, as provided in section 23 (k);

(10) In the case of such a domestic insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $3,000; but if the net income is more than $25,000 the tax imposed by this section shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(d) Deductions of foreign corporations.—In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I.

(e) Double deductions.—Nothing in this section shall be construed to permit the same item to be twice deducted.

ART. 991. **Tax on insurance companies other than life or mutual.**—For the calendar year 1928 and subsequent years all insurance companies (other than life or mutual companies) are subject to the tax imposed by section 204. Mutual insurance companies (other than life) remain subject to the tax imposed by section 13. The term "insurance companies" as used in this article and in articles 992 and 993 means only those companies subject to the tax imposed by section 204. The rate of the tax imposed by section 204 is 12 per cent, and the net income upon which the tax is imposed, as defined in section 204, differs from the net income of other corporations. Insurance companies are entitled to the benefit of section 117 (net losses) but not of section 101 (capital gains and losses). All provisions of the Act and of these regulations not inconsistent with the specific provisions of section 204 are applicable to the assessment and collection of this tax, and insurance companies are subject to the same penalties as provided in the case of returns and payment of income tax by other corporations. Since section 204 provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for computing gross income and since the annual statement is rendered on the calendar year basis, the first returns under section 204 will be for the taxable year ending December 31, 1928.

ART. 992. **Gross income of insurance companies other than life or mutual.**—Gross income as defined in section 204 (b) means the gross amount of income earned during the taxable year from interest, dividends, rents, and premium income, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners, as well as the gain derived from sale or other disposition of property. It does not include increase in liabilities during the year on account of reinsurance treaties, remittances from the home office of a foreign insurance company to the United States branch, borrowed money, gross increase due to adjustments in book value of capital assets, and premium on capital stock sold. The underwriting and investment exhibit is presumed clearly to reflect the true net income of the company, and in so far as it is not inconsistent with the provisions of the Act will be recognized and used as a basis for that purpose. All items of the exhibit, however, do not reflect an insurance company's income as defined in the Act. By reason of the definition of investment income, miscellaneous items which are intended to reflect surplus but do not properly enter into the computation of income, such as dividends declared, home office remittances and receipts, and special deposits, are ignored. Gain or

loss from agency balances and bills receivable not admitted as assets on the underwriting and investment exhibit will be ignored, excepting only such agency balances and bills receivable as have been charged off the books of the company as bad debts or, having been previously charged off, are recovered during the taxable year.

ART. 993. **Deductions allowed insurance companies other than life or mutual.**—The deductions allowable are specified in section 204, and include losses sustained from the sale or other disposition of property. The deduction of $3,000 allowed domestic companies with net income not exceeding $25,000 is identical with the specific credit allowed other corporations by section 26, and there is the same equalizing provision in the case of incomes slightly in excess of $25,000. (See article 301.) A domestic insurance company is also entitled to the credit for income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States which is allowed other domestic corporations by section 131. (See section 206.) Among the items which may not be deducted are income taxes, paid or accrued, imposed by the United States and so much of the income and profits taxes imposed by any foreign country or possession of the United States as is allowed as a credit under section 206, taxes assessed against local benefits, donations, decrease during the year due to adjustments in the book value of capital assets, decrease in liabilities during the year on account of reinsurance treaties, dividends paid to shareholders, remittances to the home office of a foreign insurance company by the United States branch, and borrowed money repaid.

SEC. 205. NET LOSSES.[1]

The benefit of the special deduction for net losses allowed by section 117 shall be allowed to insurance companies subject to the tax imposed by section 201 or 204, under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 206. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of a domestic insurance company subject to the tax imposed by section 201 or 204, to the extent provided in the case of a domestic corporation in section 131, and in such cases "net income" as used in that section means the net income as defined in this Supplement.

SEC. 207. COMPUTATION OF GROSS INCOME.

The gross income of insurance companies subject to the tax imposed by section 201 or 204 shall not be determined in the manner provided in section 119.

[1] See T. D. 4309, p. 364.

SEC. 208. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.

(a) Application of title.—Mutual insurance companies, other than life insurance companies, shall be taxable in the same manner as other corporations, except as hereinafter provided in this section.

(b) Gross income.—Mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

ART. 1001. **Gross income of mutual insurance companies other than life.**—The gross income of mutual insurance companies (other than life) consists of their total revenue from the operation of the business and of their income from all other sources within the taxable year, except as otherwise provided by the Act. Gross income includes net premiums (that is, gross premiums less returned premiums on policies canceled and premiums on policies not taken), investment income, profits from the sale of assets, and all gains, profits, and income reported to the State insurance departments, except income specifically exempt from tax. Premiums received by mutual marine insurance companies which are paid out for reinsurance should be eliminated from gross income and the payments for reinsurance from disbursements. Deposit premiums on perpetual risks received and returned by mutual fire insurance companies should be treated in the same manner, as no reserve will be recognized covering liability for such deposits. The earnings on such deposits, including such portion, if any, of the deposits as is not returned to the policyholders upon cancellation of the policies, must be included in the gross income. A net decrease in reserve funds required by law within the taxable year must be included in the gross income to the extent that such funds are released to the general uses of the company and increase its free assets. Any net decrease in reserves shall be added to the gross income, unless the company shall show that such decrease resulted from the application of reserves to the purposes for which they were established. (See articles 1011–1014.)

[**SEC. 208. MUTUAL INSURANCE COMPANIES OTHER THAN LIFE.**]

(c) Deductions.—In addition to the deductions allowed to corporations by section 23 the following deductions to insurance companies shall also be allowed, unless otherwise allowed—

(1) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE INSURANCE.—In the case of mutual insurance companies other than life insurance companies—

(A) the net addition required by law to be made within the taxable year to reserve funds (including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds); and

(B) the sums other than dividends paid within the taxable year on policy and annuity contracts.

(2) MUTUAL MARINE INSURANCE COMPANIES.—In the case of mutual marine insurance companies, in addition to the deductions allowed in paragraph (1) of this subsection, unless otherwise allowed, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(3) MUTUAL INSURANCE COMPANIES OTHER THAN LIFE AND MARINE.—In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

ART. 1011. **Deductions allowed mutual insurance companies other than life insurance companies.**—Mutual insurance companies (other than life insurance companies) are entitled to the same deductions from gross income as other corporations, and also to the deduction of the net addition required by law to be made within the taxable year to reserve funds and of the sums other than dividends paid within the taxable year on policy and annuity contracts. As to life insurance companies, see sections 201–203 and articles 951–977. Insurance companies, other than mutual and life companies, are entitled only to the deductions allowed by section 204 (c). (See article 993.) Mutual insurance companies are not entitled to the deductions allowed by section 204 (c), but (except in the case of life insurance companies) are entitled to the deductions allowed by section 23. (See articles 1012–1014.) "Paid" includes "accrued" or "incurred" (construed according to the method of accounting upon the basis of which the net income is computed) during the taxable year, but does not include any estimate for losses incurred but not reported during the taxable year.

ART. 1012. **Required addition to reserve funds of mutual insurance companies.**—Mutual insurance companies, other than life insurance companies, may deduct from gross income the net addition required by law to be made within the taxable year to reserve funds, including in the case of assessment insurance companies the actual deposit of sums with State or Territorial officers pursuant to law as additions to guarantee or reserve funds. Reserve funds "required by law" include not only reserves required by express statutory provisions but also reserves required by the rules and regulations of State insurance departments when promulgated in the exercise of an appropriate power conferred by statute, but do not include assets required

to be held for the ordinary running expenses of the business, such as taxes, salaries, reinsurance, and unpaid brokerage. Only reserves commonly recognized as reserve funds in insurance accounting are to be taken into consideration in computing the net addition to reserve funds required by law. In the case of a fire insurance company the only reserve fund commonly recognized is the "unearned-premium" fund. Casualty companies may deduct losses incurred within the taxable year; but unless the net addition to the unpaid loss reserve required by law exceeds such losses incurred, no deduction for the net addition to the unpaid loss reserve may be taken. In any event only the excess of such net addition over such losses may be deducted. Mutual hail and mutual cyclone insurance companies are entitled to deduct from gross income the net addition which they are required to make to the "guarantee surplus" fund or similar fund.

ART. 1013. **Special deductions allowed mutual marine insurance companies.**—Mutual marine insurance companies should include in gross income the gross premiums collected and received by them less amounts paid for reinsurance. (See section 208 (b) and article 1001.) They may deduct from gross income amounts repaid to policyholders on account of premiums previously paid by them, together with the interest actually paid upon such amounts between the date of ascertainment and the date of payment thereof. The remainder of the premiums accordingly forms part of the net income of the company, except to the extent that it is subject to the deductions allowed such insurance companies and other corporations.

ART. 1014. **Special deductions allowed mutual insurance companies.**—Mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life and mutual marine insurance companies), which require their members to make premium deposits to provide for losses and expenses, are allowed to deduct from gross income the aggregate amount of premium deposits returned to their policyholders or retained for the payment of losses, expenses, and reinsurance reserves. In determining the amount of premium deposits retained by a mutual fire or mutual casualty insurance company for the payment of losses, expenses, and reinsurance reserves, it will be presumed that losses and expenses have been paid out of earnings and profits other than premiums to the extent of such earnings and profits. If, however, any portion of such amount is applied during the taxable year to the payment of losses, expenses, or reinsurance reserves, for which a separate allowance is taken, then such portion is not deductible; and if any portion of such amount for which an allowance is taken is subsequently applied to

the payment of expenses, losses, or reinsurance reserves, then such payment can not be separately deducted. The amount of premium deposits retained for the payment of expenses and losses, and the amount of such expenses and losses, may not both be deducted. A company which invests part of the premium deposits so retained by it in interest-bearing securities may nevertheless deduct such part, but not the interest received on such securities. A mutual fire insurance company which has a guaranty capital is taxed like other mutual fire insurance companies. A stock fire insurance company, operated on the mutual plan to the extent of paying dividends to certain classes of policyholders, may make a return on the same basis as a mutual fire insurance company with respect to its business conducted on the mutual plan.

ART. 1015. **Returns of insurance companies.**—Insurance companies transacting business in the United States or deriving any income from sources therein are required to file returns of income. The return shall be on Form 1120, except that life insurance companies shall make return on Form 1120 L. As an aid in auditing the returns, wherever possible a copy of the report to the State insurance department should be submitted with the return. Otherwise a copy of Schedule D, parts 1, 3, and 4, of the report should be attached to the return, showing the Federal, State, and municipal obligations from which the interest omitted from gross income was derived, and a copy of the complete report should be furnished as soon as ready for filing.

SUPPLEMENT H—NONRESIDENT ALIEN INDIVIDUALS

SEC. 211. NORMAL TAX.

(a) **General rule.**—In the case of a nonresident alien individual who is not a resident of a contiguous country, the normal tax shall be 5 per centum of the amount of the net income in excess of the credits against net income allowed to such individual.

(b) **Aliens resident in contiguous countries.**—In the case of an alien individual resident in a contiguous country, the normal tax shall be an amount equal to the sum of the following:

(1) 1½ per centum of the amount by which the part of the net income attributable to wages, salaries, professional fees, or other amounts received as compensation for personal services actually performed in the United States, exceeds the personal exemption and credit for dependents; but the amount taxable at such 1½ per centum rate shall not exceed $4,000;

(2) 3 per centum of the amount by which such part of the net income exceeds the sum of (A) the personal exemption and credit for dependents, plus (B) $4,000; but the amount taxable at such 3 per centum rate shall not exceed $4,000; and

(3) 5 per centum of the amount of the net income in excess of the sum of (A) the amount taxed under paragraphs (1) and (2) of this subsection plus (B) the total credits against net income allowed to such individual.

(c) **In lieu of normal tax under section 11.**—The tax imposed by this section shall be in lieu of the normal tax imposed by section 11.

ART. 1021. **Normal tax in the case of nonresident alien individuals.**—In the case of nonresident alien individuals, residents of countries other than Canada and Mexico, the normal tax is 5 per cent of the net income in excess of the credits provided in sections 25 and 214, there being no reduction in the rate upon any part of the net income subject to tax. In the case of nonresident alien individuals, residents of Canada or Mexico, the normal tax is (1) 1½ per cent of that part of the net income attributable to compensation for personal services actually performed in the United States in excess of the personal exemption and credit for dependents, but not in excess of $4,000; (2) 3 per cent of the amount by which such part of the net income exceeds the sum of (*a*) the personal exemption and credit for dependents plus (*b*) $4,000, but the amount taxable at 3 per cent shall not exceed $4,000; (3) 5 per cent of the amount of the net income in excess of the amounts taxed at 1½ per cent and 3 per cent plus the total credits provided in sections 25 and 214.

Nonresident alien individuals are subject also to the surtax imposed by section 12. (See articles 21 and 22.)

ART. 1022. **Definition.**—A "nonresident alien individual" means an individual—

(*a*) Whose residence is not within the United States; and

(*b*) Who is not a citizen of the United States.

An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient or not is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. An alien whose stay in

the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this article.

ART. 1023. **Alien seamen, when to be regarded as residents.**—In order to determine whether an alien seaman is a resident within the meaning of the income tax law, it is necessary to decide whether the presumption of nonresidence is overcome by facts showing that he has established a residence in the territorial United States, which consists of the States, the District of Columbia, and the Territories of Hawaii and Alaska, and excludes other places. Residence may be established on a vessel regularly engaged in coastwise trade, but the mere fact that a sailor makes his home on a vessel flying the United States flag and engaged in foreign trade is not sufficient to establish residence in the United States, even though the vessel, while carrying on foreign trade, touches at American ports. An alien seaman may acquire an actual residence in the territorial United States within the rules laid down in article 1024, although the nature of his calling requires him to be absent for a long period from the place where his residence is established. An alien seaman may acquire such a residence at a sailors' boarding house or hotel, but such a claim should be carefully scrutinized in order to make sure that such residence is bona fide. The filing of Form 1078 or taking out first citizenship papers is proof of residence in the United States from the time the form is filed or the papers taken out, unless rebutted by other evidence showing an intention to be a transient. The fact that a head tax has been paid on behalf of an alien seaman entering the United States is no evidence that he has acquired residence, because the head tax is payable unless the alien who is entering the country is merely in transit through the country.

ART. 1024. **Proof of residence of alien.**—The following rules of evidence shall govern in determining whether or not an alien within the United States has acquired residence therein within the meaning of the Act. An alien, by reason of his alienage, is presumed to be a nonresident alien. Such presumption may be overcome—

(1) In the case of an alien who presents himself for determination of tax liability prior to departure for his native country, by (*a*) proof that the alien, at least six months prior to the date he so presents himself, has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (*b*) proof that the alien, at least six months prior to the date he so presents himself, has filed Form 1078 or its equivalent, or (*c*) proof of acts and statements of the alien showing a definite intention to acquire residence

in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident;

(2) In other cases by (*a*) proof that the alien has filed a declaration of his intention to become a citizen of the United States under the naturalization laws, (*b*) proof that the alien has filed Form 1078 or its equivalent, or (*c*) proof of acts and statements of an alien showing a definite intention to acquire residence in the United States or showing that his stay in the United States has been of such an extended nature as to constitute him a resident.

In any case in which an alien seeks to overcome the presumption of nonresidence under (1) (*c*) or (2) (*c*), if the officer who examines the alien is in doubt as to the facts, such officer may, to assist him in determining the facts, require an affidavit or affidavits setting forth the facts relied upon, executed by some credible person or persons, other than the alien and members of his family, who have known the alien at least six months prior to the date of execution of the affidavit or affidavits.

ART. 1025. **Loss of residence by alien.**—An alien who has acquired residence in the United States retains his status as a resident until he abandons the same and actually departs from the United States. An intention to change his residence does not change his status as a resident alien to that of a nonresident alien. Thus an alien who has acquired a residence in the United States is taxable as a resident for the remainder of his stay in the United States.

ART. 1026. **Duty of employer to determine status of alien employee.**—If wages are paid to aliens without withholding the tax, except as permitted in article 1072, the employer should be prepared to prove the status of the alien as provided in the foregoing articles. An employer may rely upon the evidence of residence afforded by the fact that an alien has filed Form 1078, or an equivalent certificate of the alien establishing residence. An employer need not secure Form 1078 from the alien if he is satisfied that the alien is a resident alien. An employer who seeks to account for failure to withhold in the past, if he had not at the time secured Form 1078 or its equivalent, is permitted to prove the former status of the alien by any competent evidence. The written statement of the alien employee may ordinarily be relied upon by the employer as proof that the alien is a resident of the United States.

SEC. 212. GROSS INCOME.

(a) General rule.—In the case of a nonresident alien individual gross income includes only the gross income from sources within the United States.

(b) Ships under foreign flag.—The income of a nonresident alien individual which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States, shall not be included in gross income and shall be exempt from taxation under this title.

ART. 1041. **Gross income of nonresident alien individuals.**—In the case of nonresident alien individuals "gross income" means only the gross income from sources within the United States, determined under the provisions of section 119. (See articles 671–684.) The items of gross income from sources without the United States and therefore not taxable to nonresident aliens are described in section 119 (c) and article 677. As to who are nonresident alien individuals, see articles 1022–1026.

ART. 1042.[1] **Exclusion of earnings of foreign ships from gross income.**—So much of the income from sources within the United States of a nonresident alien individual as consists of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States nonresident in such foreign country and to corporations organized in the United States, shall not be included in gross income.

(*a*) The following is an incomplete list of the foreign countries which either impose no income tax, or, in imposing such tax, exempt from taxation so much of the income of a citizen of the United States nonresident in such foreign country and of a corporation organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States: Argentina, Bulgaria, Canada, Denmark, Egypt, France, Germany, Great Britain and Northern Ireland, Iceland, Italy, Japan, the Netherlands, Norway, Paraguay, Persia, St. Lucia, Siam, Straits Settlements, Sweden, and Venezuela. The exemption accorded to Great Britain and Northern Ireland does not extend to the Irish Free State but is limited to residents of Great Britain and Northern Ireland, other than citizens of the United States, and to corporations organized under and existing by virtue of the laws of the United Kingdom.

(*b*) The following is an incomplete list of the foreign countries which, in imposing an income tax upon the income of citizens of the United States nonresident in such countries or of corporations organized in the United States, do not exempt from taxation the earnings derived from the operation of a ship or ships documented under the laws of the United States: Antigua, Belgium, Brazil, British

[1] See T. Ds. 4269, 4289, and 4299, pp. 365–366.

Honduras, Costa Rica, Dominica, Fiji, Finland, Greece, Grenada, India, Jamaica, New Zealand, Peru, St. Vincent, Spain, Trinidad, and Union of South Africa.

So much of the income from sources within the United States of a nonresident alien individual as consists of earnings derived from the operation of a ship or ships documented under the laws of any of the countries in the first list is not required to be included in the gross income of such nonresident alien individual for the purpose of Federal income tax. The income from sources within the United States of a nonresident alien individual which consists of earnings derived from the operation of a ship or ships documented under the laws of any of the countries in the second list is required to be included in the gross income of such nonresident alien individual and is subject to Federal income tax. If a nonresident alien individual receives income from sources within the United States consisting of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which is in neither list, the amount so received must be included in gross income unless satisfactory proof is furnished either (*a*) that such foreign country imposes no income tax, or (*b*) if an income tax is imposed that the foreign statute grants an equivalent exemption to citizens of the United States nonresident in such country and to corporations organized in the United States.

SEC. 213. DEDUCTIONS.

(a) General rule.—In the case of a nonresident alien individual the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the United States shall be determined as provided in section 119, under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

(b) Losses.—

(1) The deduction, for losses not connected with the trade or business if incurred in transactions entered into for profit, allowed by section 23 (e) (2) shall be allowed whether or not connected with income from sources within the United States, but only if the profit, if such transaction had resulted in a profit, would be taxable under this title.

(2) The deduction for losses of property not connected with the trade or business if arising from certain casualties or theft, allowed by section 23 (e) (3), shall be allowed whether or not connected with income from sources within the United States, but only if the loss is of property within the United States.

(c) Charitable, etc., contributions.—The so-called "charitable contribution" deduction allowed by section 23 (n) shall be allowed whether or not connected with income from sources within the United States,

but only as to contributions or gifts made to domestic corporations, or to community chests, funds, or foundations, created in the United States, or to the vocational rehabilitation fund.

ART. 1051. **Deductions allowed nonresident alien individuals.**—In the case of a nonresident alien individual the deductions allowed by section 23 for business expenses, interest, taxes, losses in trade, bad debts, depreciation, and depletion are allowed only if and to the extent that they are connected with income from sources within the United States. (See also section 215 and article 1071.) In the case of such taxpayers, however, (1) losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business, are deductible only if and to the extent that the profit, if such transaction had resulted in a profit, would have been taxable as income from sources within the United States; (2) losses sustained during the taxable year of property not connected with the trade or business if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise, are deductible only if the property was located within the United States; and (3) contributions or gifts made within the taxable year are deductible only if made to domestic corporations or to community chests, funds, or foundations, created in the United States of the type specified in section 23 (n) and article 261, or to the vocational rehabilitation fund, subject to the limitation provided in section 23 (n).

Losses embraced under clause (2) of the preceding paragraph are deductible in full from items of gross income specified as being derived in full from sources within the United States, and, if greater than the sum of such items, the unabsorbed loss may be deducted from the income apportioned to sources within the United States under the provisions of article 682. Losses embraced under clause (1) are deductible in full (as provided in article 680 or article 681) when the profit from the transaction, if it had resulted in a profit, would have been taxable in full as income from sources within the United States, but should be deducted under the provisions of article 682 when the profit from the transaction, if it had resulted in profit, would have been taxable only in part.

SEC. 214. CREDITS AGAINST NET INCOME.

In the case of a nonresident alien individual the personal exemption allowed by section 25 (c) of this title shall be only $1,500. The credit for dependents allowed by section 25 (d) shall not be allowed in the case of a nonresident alien individual unless he is a resident of a contiguous country. These credits shall be determined by the status

of the taxpayer on the last day of the taxable year, except that in case of death the rule provided in section 25 (e) (3) shall be applied.

ART. 1061. **Credits to nonresident alien individual.**—The personal exemption allowed as a credit against net income by section 25 (c) shall be $1,500 in the case of a nonresident alien individual irrespective of marital status. The credit for dependents provided by section 25 (d) is allowed to nonresident alien individuals only if they are residents of Canada or Mexico. The credit for dependents shall be determined by the status of the taxpayer at the end of the taxable year except that in case of death the rule provided in section 25 (e) (3) shall be applied.

SEC. 215. ALLOWANCE OF DEDUCTIONS AND CREDITS.

(a) **Return to contain information.**—A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this title only by filing or causing to be filed with the collector a true and accurate return of his total income received from all sources in the United States, in the manner prescribed in this title; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

(b) **Tax withheld at source.**—The benefit of the personal exemption and credit for dependents, and of the reduced rate of tax provided for in section 211 (b), may, in the discretion of the Commissioner and under regulations prescribed by him with the approval of the Secretary, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

ART. 1071. **Allowance of deductions and credits to nonresident alien individuals.**—Unless a nonresident alien individual shall file, or cause to be filed with the collector, a true and accurate return of income from sources within the United States, regardless of amount, the tax shall be collected on the basis of the gross income (not the net income) from sources within the United States. Where a nonresident alien has various sources of income within the United States, so that from any one source or from all sources combined the amount of income shall call for the assessment of a surtax, and a return of income shall not be filed by him or on his behalf, the Commissioner will cause a return of income to be made and include therein the income of such nonresident alien from all sources concerning which he has information, and he will assess the tax and collect it from one or more of the sources of income of such nonresident alien within the United States, without allowance for deductions or credits. The benefit of the credits allowed against net income for the purpose of the normal tax may be claimed by a nonresident alien only in his individual return, except that the personal exemption (and credit for dependents in the case of a resident of Canada or Mexico)

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may be obtained by filing a claim therefor with the withholding agent in accordance with the provisions of articles 764 and 1072.

ART. 1072. **Allowance of personal exemption to nonresident alien employee.**—A nonresident alien employee may claim the benefit of the personal exemption (sections 25 and 214) by filing with his employer Form 1115 duly filled in and executed under oath. If the alien employee is a resident of Canada or Mexico, he may also obtain the benefit of the credit for dependents (sections 25 and 214) and the benefit of the reduced rates of tax (section 211 (b)) by filing Form 1115 with his employer. On the filing of such a claim the employer shall examine it. If on such examination it appears that the claim is in due form, that it contains no statement which to the knowledge of the employer is untrue, that such employee on the face of the claim is entitled to credit, and that such credit has not yet been exhausted, such employer need not until such credit is in fact exhausted withhold any tax from payments of salary or wages made to such employee. Every employer with whom claims on Form 1115 are filed by employees shall preserve such claims until the following calendar year, and shall then file them, attached to his annual withholding return on Form 1042, with the collector on or before March 15. In case, however, when the following calendar year arrives such employer has no withholding to return, he shall forward all such claims directly to the Commissioner, with a letter of transmittal, on or before March 15. Where any tax is withheld the employer in every instance shall show on the pay envelope or shall furnish some other memorandum showing the name of the employee, the date, and the amount withheld. This article applies only to payments of compensation by an employer to an employee. (See further section 144 and articles 761–770.)

SEC. 216. CREDITS AGAINST TAX.

A nonresident alien individual shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

SEC. 217. RETURNS.

In the case of a nonresident alien individual the return, in lieu of the time prescribed in section 53 (a) (1), shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, then on or before the fifteenth day of June.

ART. 1081. **Return of income of nonresident alien individuals.**—Returns in the case of nonresident alien individuals must be made on or before the fifteenth day of the sixth month following the close

of the fiscal year or on or before the 15th day of June, if on the basis of the calendar year. A nonresident alien individual shall make or have made a full and accurate return on Form 1040 B of his income received from sources within the United States, regardless of amount, unless the tax on such income has been fully paid at the source. The responsible representatives or agents of nonresident aliens in connection with any sources of income which such nonresident aliens may have within the United States shall make a return of the income from such sources, and shall pay any normal tax or surtax assessed upon the income received by them in behalf of their nonresident alien principals, in all cases where the tax on income so in their receipt, custody, or control shall not have been withheld at the source. The agency appointment will determine how completely the agent is substituted for the principal for tax purposes. A bank or trust company which collects interest or dividends on deposited securities of a nonresident alien, executes ownership certificates in connection therewith, and sells such securities under special instructions shall not be deemed merely by reason of such acts to be the responsible representative or agent of the nonresident alien, and shall not be required to make a return of the income received by it in connection with such deposited securities or to pay any tax thereon, except in cases where the amount of such income is $1,500 or over, unless specially appointed for that purpose or unless by reason of other facts it has become such responsible representative or agent. Where upon filing a return of income it appears that a nonresident alien is not liable for tax, but nevertheless a tax shall have been withheld at the source, in order to obtain a refund on the basis of the showing made by the return there should be attached to it a statement showing accurately the amounts of tax withheld, with the names and post-office addresses of all withholding agents. (See article 764.)

SEC. 218. PAYMENT OF TAX.

(a) Time of payment.—In the case of a nonresident alien individual the total amount of tax imposed by this title shall be paid, in lieu of the time prescribed in section 56 (a), on the fifteenth day of June following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the sixth month following the close of the fiscal year.

(b) Withholding at source.—For withholding at source of tax on income of nonresident aliens, see section 144.

ART. 1091. **Date on which tax shall be paid by nonresident alien individual.**—In the case of a nonresident alien individual the tax is to be paid on or before the fifteenth day of June following the close

of the calendar year, or, where the return is made on the basis of a fiscal year, on or before the fifteenth day of the sixth month following the close of the fiscal year. As to payment of the tax in installments, see article 431.

SUPPLEMENT I—FOREIGN CORPORATIONS

SEC. 231. GROSS INCOME.

(a) **General rule.**—In the case of a foreign corporation gross income includes only the gross income from sources within the United States.

(b) **Ships under foreign flag.**—The income of a foreign corporation, which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States, shall not be included in gross income and shall be exempt from taxation under this title.

ART. 1101. **Gross income of foreign corporations.**—The gross income of a foreign corporation, including a mutual insurance company other than a life insurance company, means its gross income from sources within the United States, as defined and described in section 119 and articles 671–684. As to foreign life insurance companies, see article 977.

ART. 1102. **Exclusion of earnings of foreign ships from gross income.**—A foreign corporation may exclude from gross income under section 231 (b) so much of its income from sources within the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of a foreign country, to the same extent as nonresident alien individuals as provided in article 1042.

SEC. 232. DEDUCTIONS.

In the case of a foreign corporation the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119, under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

ART. 1111. **Deductions allowed foreign corporations.**—Foreign corporations are allowed the same deductions from their gross income arising from sources within the United States as are allowed to domestic corporations to the extent that such deductions are connected with such gross income. The proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119 and articles 680–684. As to foreign life insurance companies, see article 977.

SEC. 233. ALLOWANCE OF DEDUCTIONS AND CREDITS.

A foreign corporation shall receive the benefit of the deductions and credits allowed to it in this title only by filing or causing to be filed with the collector a true and accurate return of its total income received from all sources in the United States, in the manner prescribed in this title; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

SEC. 234. CREDITS AGAINST TAX.

Foreign corporations shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

SEC. 235. RETURNS.

In the case of a foreign corporation not having any office or place of business in the United States the return, in lieu of the time prescribed in section 53 (a) (1), shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year then on or before the fifteenth day of June. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent.

SEC. 236. PAYMENT OF TAX.

(a) **Time of payment.**—In the case of a foreign corporation the total amount of tax imposed by this title shall be paid, in lieu of the time prescribed in section 56 (a), on the fifteenth day of June following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the sixth month following the close of the fiscal year.

(b) **Withholding at source.**—For withholding at source of tax on income of foreign corporations, see section 144.

ART. 1121. **Date on which tax shall be paid by foreign corporations.**—In the case of a foreign corporation the tax is to be paid on or before the fifteenth day of June following the close of the calendar year, or, where the return is made on the basis of a fiscal year, on or before the fifteenth day of the sixth month following the close of the fiscal year. As to payment of the tax in installments, see article 431.

SEC. 237. FOREIGN INSURANCE COMPANIES.

For special provisions relating to foreign insurance companies, see Supplement G.

SEC. 238. AFFILIATION.

A foreign corporation shall not be deemed to be affiliated with any other corporation within the meaning of section 141 or 142.

SUPPLEMENT J—POSSESSIONS OF THE UNITED STATES

SEC. 251. INCOME FROM SOURCES WITHIN POSSESSIONS OF UNITED STATES.

(a) **General rule.**—In the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States—

(1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section), for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

(2) If, in the case of such corporation, 50 per centum or more of its gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States; or

(3) If, in case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another.

(b) **Amounts received in United States.**—Notwithstanding the provisions of subsection (a) there shall be included in gross income all amounts received by such citizens or corporations within the United States, whether derived from sources within or without the United States.

(c) **Definition.**—As used in this section the term "possession of the United States" does not include the Virgin Islands of the United States.

(d) **Deductions.**—

(1) Citizens of the United States entitled to the benefits of this section shall have the same deductions as are allowed by Supplement H in the case of a nonresident alien individual.

(2) Domestic corporations entitled to the benefits of this section shall have the same deductions as are allowed by Supplement I in the case of a foreign corporation.

(e) **Credits against net income.**—

(1) CITIZENS.—A citizen of the United States entitled to the benefits of this section shall be allowed a personal exemption of only $1,500 and shall not be allowed the credit for dependents provided in section 25 (d). The personal exemption shall be determined by the status of the taxpayer on the last day of the taxable year, except that in case of death the rule provided in section 25 (e) (3) shall be applied.

(2) A domestic corporation entitled to the benefits of this section shall not be allowed the specific credit of $3,000 provided in section 26.

(f) **Allowance of deductions and credits.**—Citizens of the United States and domestic corporations entitled to the benefits of this section shall receive the benefit of the deductions and credits allowed to them in this title only by filing or causing to be filed with the collector a true and accurate return of their total income received from all sources in the United States, in the manner prescribed in this title; including therein all the information which the Commissioner may deem necessary for the calculation of such deductions and credits.

(g) **Credits against tax.**—Persons entitled to the benefits of this section shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

(h) **Affiliation.**—A corporation entitled to the benefits of this section shall not be deemed to be affiliated with any other corporation within the meaning of section 141 or 142.

ART. 1131. **Citizens of the United States and domestic corporations deriving income from sources within a possession of the United States.**—In the case of a citizen of the United States or a domestic corporation satisfying the following conditions, gross income means only gross income from sources within the United States—

(1) If 80 per cent or more of the gross income of such citizen or domestic corporation (computed without the benefit of section 251) for the three-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States, and

(2) If 50 per cent or more of the gross income of such citizen or domestic corporation (computed without the benefit of section 251) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States. In the case of a citizen, the trade or business may be conducted on his own account or as an employee or agent of another.

For a determination of the income from sources within the United States, see section 119 and articles 671–684. A citizen entitled to the benefits of section 251 is required to file with his individual return the schedule on Form 1040 E.

Example: On July 1, 1928, A, who is a citizen of the United States, went to Porto Rico and established a business there which he actively conducted during the remainder of that year. His gross income from the business during such period was $20,000. In addition, he made a profit of $12,000 from the sale during the latter part of 1928 of some Porto Rican real estate not connected with his trade or business. In the first six months of 1928 he also derived $8,000 gross income from rental property located in the United States.

He derived a like amount of gross income from such property during the last six months of 1928. Inasmuch as for the applicable part (July 1, 1928, to December 31, 1928) of the three-year period immediately preceding the close of the taxable year, 80 per cent of A's gross income ($32,000, or 80 per cent of $40,000) was derived from sources within a possession of the United States and as 50 per cent or more of his gross income ($20,000, or 50 per cent of $40,000) for such part of the three-year period was derived from the active conduct of a trade or business within a possession of the United States, he is required to report in gross income in his return for 1928 only the gross income derived by him from sources within the United States ($16,000 from the rental property located in the United States).

ART. 1132. **Income received within the United States.**—Notwithstanding the provisions of section 251 (a) and article 1131, there shall be included in the gross income of citizens and domestic corporations therein specified all amounts, whether derived from sources within or without the United States, which are received by such citizens or corporations within the United States. But see section 116 (a). From the amounts so included in gross income there shall be deducted only the expenses properly apportioned or allocated thereto. The term "United States" as used herein includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia. The term "possession of the United States" as used in section 251, article 1131, and this article includes Porto Rico, the Philippine Islands, the Panama Canal Zone, Guam, Tutuila, Wake, and Palmyra; it does not include the Virgin Islands.

ART. 1133. **Deductions allowed citizens and domestic corporations entitled to the benefits of section 251.**—In the case of a citizen entitled to the benefits of section 251, the deductions allowed by section 23 for business expenses, interest, taxes, losses in trade, bad debts, depreciation, and depletion are allowed only if and to the extent that they are connected with income from sources within the United States. The provisions of article 1051 relating to the allowance to nonresident alien individuals of the deductions provided in paragraphs (2) and (3) of section 23 (e) for losses not connected with the trade or business are applicable in the case of citizens entitled to the benefits of section 251. The provisions of that article pertaining to the allowance to nonresident alien individuals of deductions for contributions provided in section 23 (n) are also applicable in the case of such citizens. Corporations entitled to the benefits of section 251 are allowed the same deductions from their gross income arising from sources within the United States as are allowed to domestic corporations to the extent that such deductions are connected with such gross income. The proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119 and articles 680–684.

ART. 1134. **Allowance of deductions and credits to citizens and domestic corporations entitled to the benefits of section 251.**—Unless a citizen of the United States or a domestic corporation entitled to the benefits of section 251 shall file, or cause to be filed with the collector, a true and accurate return of income from sources within the United States, regardless of amount, the tax shall be collected on the basis of the gross income (not the net income) from sources within the United States. Where such a citizen or corporation has various sources of income within the United States so that from any one source or from all sources combined the amount of income shall call for the assessment of a tax, and a return of income shall not be filed by or on behalf of the citizen or corporation, the Commissioner will cause a return of income to be made and include therein the income of such citizen or corporation from all sources concerning which he has information, and he will assess the tax and collect it from one or more of the sources of income of such citizen or corporation within the United States without allowance for deductions or credits.

SEC. 252. CITIZENS OF POSSESSIONS OF UNITED STATES.

(a) Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this title only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources.

(b) Nothing in this section shall be construed to alter or amend the provisions of the Act entitled "An Act making appropriations for the naval service for the fiscal year ending June 30, 1922, and for other purposes," approved July 12, 1921, relating to the imposition of income taxes in the Virgin Islands of the United States.

ART. 1141. **Status of citizens of United States possession.**—A citizen of a possession of the United States (except the Virgin Islands), who is not otherwise a citizen or a resident of the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, is treated for the purpose of the tax as if he were a nonresident alien individual. (See sections 211–218 and articles 1021–1091.) His income from sources within the United States is subject to withholding. (See section 144 and articles 761–770.) The Act referred to in section 252 (b) provides that income

tax laws then or thereafter in force in the United States shall apply to the Virgin Islands, but that the taxes shall be paid into the treasury of the Virgin Islands. Accordingly, persons are taxed there under the provisions of the Revenue Act of 1928.

SUPPLEMENT K—CHINA TRADE ACT CORPORATIONS

SEC. 261. CREDIT AGAINST NET INCOME.

(a) **Allowance of credit.**—For the purpose only of the tax imposed by section 13 there shall be allowed, in the case of a corporation organized under the China Trade Act, 1922, in addition to the credits provided in section 26, a credit against the net income of an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 119) which the par value of the shares of stock of the corporation owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on such date: *Provided*, That in no case shall the amount by which the tax imposed by section 13 is diminished by reason of such credit exceed the amount of the special dividend certified under subsection (b) of this section.

(b) **Special dividend.**—Such credit shall not be allowed unless the Secretary of Commerce has certified to the Commissioner—

(1) The amount which, during the year ending on the date fixed by law for filing the return, the corporation has distributed as a special dividend to or for the benefit of such persons as on the last day of the taxable year were resident in China, the United States, or possessions of the United States, or were individual citizens of the United States or China, and owned shares of stock of the corporation;

(2) That such special dividend was in addition to all other amounts, payable or to be payable to such persons or for their benefit, by reason of their interest in the corporation; and

(3) That such distribution has been made to or for the benefit of such persons in proportion to the par value of the shares of stock of the corporation owned by each; except that if the corporation has more than one class of stock, the certificates shall contain a statement that the articles of incorporation provide a method for the apportionment of such special dividend among such persons, and that the amount certified has been distributed in accordance with the method so provided.

(c) **Ownership of stock.**—For the purposes of this section shares of stock of a corporation shall be considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested.

(d) **Definition of China.**—As used in this section the term "China" shall have the same meaning as when used in the China Trade Act, 1922.

SEC. 262. CREDITS AGAINST THE TAX.

A corporation organized under the China Trade Act, 1922, shall not be allowed the credits against the tax for taxes of foreign countries and possessions of the United States allowed by section 131.

SEC. 263. AFFILIATION.

A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of section 141 or 142.

SEC. 264. INCOME OF SHAREHOLDERS.

For exclusion of dividends from gross income, see section 116.

ART. 1151. **Income of China Trade Act corporations.**—The items of gross income to be included in the return of a corporation organized under the China Trade Act and the deductions allowable are the same as in the case of other domestic corporations.

ART. 1152. **Credits allowed China Trade Act corporations.**—In addition to the credits allowed under section 26, a China Trade Act corporation is, under certain conditions, allowed an additional credit for the purpose of computing the tax imposed by section 13. This credit is an amount equal to the proportion of the net income derived from sources within China (determined in a similar manner to that provided in section 119) which the par value of the shares of stock of the corporation, owned on the last day of the taxable year by (1) persons resident in China, the United States, or possessions of the United States, and (2) individual citizens of the United States or China wherever resident, bears to the par value of the whole number of shares of stock of the corporation outstanding on that date. The decrease in tax by reason of such credit must not, however, exceed the amount of the special dividend referred to in section 261 (b), and is not allowable unless the special dividend has been certified to the Commissioner by the Secretary of Commerce. A China Trade Act corporation is not entitled to the credit for taxes paid to foreign countries and possessions of the United States allowed to domestic corporations under the provisions of section 131.

ART. 1153. **Meaning of terms used in connection with China Trade Act corporations.**—A China Trade Act corporation is one organized under the provisions of the China Trade Act, 1922.

The term "China" means (1) China, including Manchuria, Thibet, Mongolia, and any territory leased by China to any foreign government, (2) the Crown Colony of Hongkong, and (3) the Province of Macao.

The term "special dividend" means the amount which during the year ending on March 15 succeeding the close of the corporation's taxable year is distributed as a special dividend to or for the benefit of such persons as on the last day of the taxable year were resident in China, the United States, or possessions of the United States, or were individual citizens of the United States or China, and owned shares of stock of the corporation. Such special dividend does not include any other amounts payable or to be payable to such persons or for their benefit by reason of their interest in the corporation and must be made in proportion to the par value of the shares of stock of the corporation owned by each.

For the purposes of section 261 the shares of stock of a China Trade Act corporation are considered to be owned by the person in whom the equitable right to the income from such shares is in good faith vested.

A corporation organized under the China Trade Act shall not be deemed to be affiliated with any other corporation within the meaning of sections 141 and 142. (See also section 263.)

"Net income derived from sources within China" is the sum of the net income from sources wholly within China and that portion of the net income from sources partly within and partly without China which may be allocated to sources within China. The method of computing this income is similar to that described in section 119 and articles 671–684.

ART. 1154. **Withholding by a China Trade Act corporation.**—Dividends paid by a China Trade Act corporation to persons other than residents of China are subject to both normal tax and surtax. Accordingly, tax should be withheld from such dividends when paid to persons (other than residents of China) who are (1) nonresident alien individuals, (2) nonresident partnerships (see article 1319) composed in whole or in part of nonresident aliens, or (3) nonresident foreign corporations (see article 1319), unless under section 119 (a) (2) (A) the dividends are not treated as income from sources within the United States. In the case of an individual shareholder or partnership, the rate of withholding is 5 per cent, and in the case of payments to a corporation after the enactment of the Revenue Act of 1928, 12 per cent. A Filipino shareholder of a China Trade Act corporation, when resident without the United States, is treated as a nonresident alien for the purpose of the income tax, and withholding is required from taxable dividends paid to such shareholder.

SUPPLEMENT L—ASSESSMENT AND COLLECTION OF DEFICIENCIES

SEC. 271. DEFINITION OF DEFICIENCY.

As used in this title in respect of a tax imposed by this title "deficiency" means—

(a) The amount by which the tax imposed by this title exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a deficiency, and decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax; or

(b) If no amount is shown as the tax by the taxpayer upon his return, or if no return is made by the taxpayer, then the amount by which the tax exceeds the amounts previously assessed (or collected without assessment) as a deficiency; but such amounts previously assessed, or collected without assessment, shall first be decreased by the amounts previously abated, credited, refunded, or otherwise repaid in respect of such tax.

ART. 1161. **Deficiency defined.**—Section 271 by its definition of the word "deficiency" provides a term which will apply to any amount of tax determined to be due in respect of the taxable year 1928 or subsequent taxable years or periods in excess of the amount of tax reported by the taxpayer for such years or periods; or in excess of the amount reported by the taxpayer as adjusted by way of prior assessments, abatements, credits, refunds, or collections without assessment. In defining the term "deficiency" section 271 recognizes two classes of cases—one, where the taxpayer makes a return showing some tax liability; the other, where the taxpayer makes a return showing no tax liability, or where the taxpayer fails to make a return. Additional tax shown on an "amended return," so-called, is a deficiency within the meaning of the Act.

When a case is considered for the first time, the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount shown as the tax by the taxpayer on his return, or, if it is a case where no tax was reported by the taxpayer, the deficiency is the amount determined to be the correct amount of the tax. Subsequent information sometimes discloses that the amount previously determined to be the correct amount of the tax is less than the correct amount, and that a redetermination of the tax is necessary. In such a case the deficiency on redetermination is the excess of the amount determined to be the correct amount of the tax over the sum of the amount of tax reported by the taxpayer and the deficiency assessed in connection with the previous determination.

If it is a case where no tax was reported by the taxpayer, the deficiency is the excess of the amount determined to be the correct amount of the tax over the amount of the deficiency disclosed by the previous determination. If the previous determination resulted in a credit or refund to the taxpayer, the deficiency upon the second determination is the excess of the amount determined to be the correct amount of the tax over the amount of tax reported by the taxpayer decreased by the amount of the credit or refund.

SEC. 272. PROCEDURE IN GENERAL.

(a) **Petition to Board of Tax Appeals.**—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. No assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. Notwithstanding the provisions of section 3224 of the Revised Statutes the making of such assessment or the beginning of such proceeding or distraint during the time such prohibition is in force may be enjoined by a proceeding in the proper court.

For exceptions to the restrictions imposed by this subsection, see—

(1) Subsection (d) of this section, relating to waivers by the taxpayer;

(2) Subsection (f) of this section, relating to notifications of mathematical errors appearing upon the face of the return;

(3) Section 273, relating to jeopardy assessments;

(4) Section 274, relating to bankruptcy and receiverships; and

(5) Section 1001 of the Revenue Act of 1926, as amended, relating to assessment or collection of the amount of the deficiency determined by the Board pending court review.

(b) **Collection of deficiency found by Board.**—If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

(c) **Failure to file petition.**—If the taxpayer does not file a petition with the Board within the time prescribed in subsection (a) of this section, the deficiency, notice of which has been mailed to the taxpayer, shall be assessed, and shall be paid upon notice and demand from the collector.

(d) **Waiver of restrictions.**—The taxpayer shall at any time have the right, by a signed notice in writing filed with the Commissioner, to waive the restrictions provided in subsection (a) of this section on the assessment and collection of the whole or any part of the deficiency.

(e) **Increase of deficiency after notice mailed.**—The Board shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed—if claim therefor is asserted by the Commissioner at or before the hearing or a rehearing.

(f) **Further deficiency letters restricted.**—If the Commissioner has mailed to the taxpayer notice of a deficiency as provided in subsection (a) of this section, and the taxpayer files a petition with the Board within the time prescribed in such subsection, the Commissioner shall have no right to determine any additional deficiency in respect of the same taxable year, except in the case of fraud, and except as provided in subsection (e) of this section, relating to assertion of greater deficiencies before the Board, or in section 273 (c), relating to the making of jeopardy assessments. If the taxpayer is notified that, on account of a mathematical error appearing upon the face of the return, an amount of tax in excess of that shown upon the return is due, and that an assessment of the tax has been or will be made on the basis of what would have been the correct amount of tax but for the mathematical error, such notice shall not be considered (for the purposes of this subsection, or of subsection (a) of this section, prohibiting assessment and collection until notice of deficiency has been mailed, or of section 322 (c), prohibiting credits or refunds after petition to the Board of Tax Appeals) as a notice of a deficiency, and the taxpayer shall have no right to file a petition with the Board based on such notice, nor shall such assessment or collection be prohibited by the provisions of subsection (a) of this section.

(g) **Jurisdiction over other taxable years.**—The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

(h) **Final decisions of Board.**—For the purposes of this title the date on which a decision of the Board becomes final shall be determined according to the provisions of section 1005 of the Revenue Act of 1926.

(i) **Prorating of deficiency to installments.**—If the taxpayer has elected to pay the tax in installments and a deficiency has been assessed, the deficiency shall be prorated to the four installments. Except as provided in section 273 (relating to jeopardy assessments), that part of the deficiency so prorated to any installment the date for payment of which has not arrived, shall be collected at the same time as and as part of such installment. That part of the deficiency so prorated to any installment the date for payment of which has arrived, shall be paid upon notice and demand from the collector.

(j) **Extension of time for payment of deficiencies.**—Where it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the date prescribed for the payment thereof will result in undue hardship to the taxpayer the Commissioner, with the approval of the Secretary (except where the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax), may grant an extension for the payment of such deficiency or any part thereof for a period not in excess of eighteen months, and, in exceptional cases, for a further period not in excess of twelve months. If an extension is granted, the Commissioner may require the taxpayer to furnish a bond in such amount, not exceeding double the amount of the deficiency, and with such sureties, as the Commissioner deems necessary, conditioned upon the payment of the deficiency in accordance with the terms of the extension.

(k) **Address for notice of deficiency.**—In the absence of notice to the Commissioner under section 312 (a) of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by this title, if mailed to the taxpayer at his last known address, shall be sufficient for the purposes of this title even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

ART. 1171. **Assessment of a deficiency.**—If the Commissioner determines that there is a deficiency in respect of the income tax imposed by Title I of the Revenue Act of 1928 (see sections 57 and 271 and articles 451 and 1161), the Commissioner is authorized to notify the taxpayer of the deficiency by registered mail. Within 60 days after such notice is mailed, a petition may be filed with the Board of Tax Appeals for a redetermination of the deficiency. In determining such 60-day period, Sunday is not to be counted as the sixtieth day. Except as stated in paragraphs (1), (2), (3), (4), and (5) of this article, no assessment of a deficiency in respect of a tax imposed by Title I shall be made until such notice has been mailed to the taxpayer, nor until the expiration of such 60-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. As to the date on which a decision of the Board becomes final, see section 1005 of the Revenue Act of 1926.

(1) If a taxpayer is notified of an additional amount of tax due on account of a mathematical error appearing upon the face of the return, such notice is not to be considered as a notice of a deficiency, and the taxpayer has no right to file a petition with the Board upon the basis of such notice, nor is the assessment of such additional tax prohibited by the provisions of section 272 (a).

(2) If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, such deficiency shall be assessed immediately, as provided in section 273. (See article 1181.)

(3) Upon the adjudication of bankruptcy of any taxpayer in any bankruptcy proceeding or the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency determined by the Commissioner in respect of the tax shall be assessed immediately, irrespective of the provisions of section 272 (a), if such deficiency has not been assessed in accordance with law prior to the adjudication of bankruptcy or the appointment of a receiver. (See sections 274 and 298 and articles 1191 and 1192.)

(4) (*a*) If the Board renders a decision and determines that there is a deficiency, and, if the taxpayer duly files a petition for review of the decision by a circuit court of appeals (or the Court of Appeals of the District of Columbia), the filing of the petition will not operate as a stay of the assessment of any portion of the deficiency determined by the Board unless he has filed a bond with the Board as provided in section 1001 (c) of the Revenue Act of 1926, as amended by section 603 of the Revenue Act of 1928. If in such a case the necessary bond has not been filed by the taxpayer, the amount determined by the Board as the deficiency will be assessed immediately after the filing of such petition.

(*b*) If the Commissioner files a petition for review and (1) if the taxpayer has not filed a petition for review within six months after the decision of the Board is rendered, or (2) if such petition has been filed by the taxpayer, but the necessary bond referred to in section 1001 (c) of the Revenue Act of 1926, as amended, has not been filed with the Board, the amount determined by the Board as the deficiency will be assessed in the case of (1), immediately after the expiration of the six-months period, and in the case of (2), immediately after the filing of the petition for review by the taxpayer.

(5) The taxpayer may at any time by a signed notice in writing filed with the Commissioner waive the restrictions on the assessment of the whole or any part of the deficiency. The notice must in all cases be filed with the Commissioner. The filing of such notice with the Board does not constitute filing with the Commissioner within the meaning of the Act. After such waiver has been acted upon by the Commissioner and the assessment has been made in accordance with its terms, the waiver can not be withdrawn.

Where a petition is filed with the Board, the taxpayer should notify the Commissioner that the petition has been filed, in order to prevent an assessment by the Commissioner of the amount determined to be the deficiency. If no petition is filed with the Board

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within the period prescribed, the Commissioner shall asssess the amount determined by him as the deficiency and of which he has notified the taxpayer by registered mail. In such case the Commissioner will not be precluded from determining a further deficiency and notifying the taxpayer thereof by registered mail. Where a petition is filed with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed by the Commissioner. If the Commissioner mails to the taxpayer notice of a deficiency, and the taxpayer files a petition with the Board within the prescribed period, the Commissioner is barred from determining any additional deficiency for the same taxable year except in the case of fraud and except as provided in section 272 (e) relating to the assertion of greater deficiencies before the Board or in section 273 relating to jeopardy assessments.

ART. 1172. **Collection of a deficiency.**—Where a deficiency as redetermined by a decision of the Board which has become final is assessed, or where the taxpayer has not filed a petition and the deficiency as determined by the Commissioner has been assessed, the amount so assessed shall be paid upon notice and demand from the collector. As to cases coming within the provisions of paragraphs (2), (3), and (4) of article 1171, see sections 273 (i) and 298 of the Revenue Act of 1928 and 1001 (c) of the Revenue Act of 1926, as amended by section 603 of the Revenue Act of 1928. As to interest on deficiencies, see section 292.

ART. 1173.[1] **Extension of time for payment of a deficiency.**—Where it is shown to the satisfaction of the Commissioner that the payment of a deficiency upon the date or dates prescribed for payment thereof will result in undue hardship to the taxpayer, the Commissioner, with the approval of the Secretary, may grant an extension of time for the payment of the deficiency or any part thereof for a period not in excess of 18 months, and in exceptional cases for a further period not in excess of 12 months. The term "undue hardship" means more than an inconvenience to the taxpayer. It must appear that substantial financial loss or sacrifice will result to the taxpayer from making payment of the deficiency at the due date. The Act provides that no extension will be granted where the deficiency is due to negligence or intentional disregard of rules and regulations or to fraud with intent to evade tax.

An application for an extension of time for the payment of a deficiency should be made under oath on Form 1127 and must be accompanied by evidence showing that undue hardship to the taxpayer would result if the extension were refused. The extension will not be granted on a general statement of hardship, but in each case there

[1] See T. D. 4315, p. 367.

must be furnished a statement of the specific facts showing what, if any, financial loss or sacrifice will result if the extension is not granted. Wherever practicable a certified statement of assets and liabilities of the taxpayer should be submitted. The application, with the evidence, must be filed with the collector, who will at once transmit it to the Commissioner with his recommendations as to the extension. When it is received by the Commissioner, it will be examined immediately and, if possible, within 30 days will be rejected, approved, or tentatively approved subject to certain conditions of which the taxpayer will be immediately notified.

As a condition to the granting of such an extension, the Commissioner may require the taxpayer to furnish a bond on Form 1127 B in an amount not exceeding double the amount of the deficiency. If a bond is required it must be filed with the collector within 10 days after notification by the Commissioner that such bond is required. It shall be conditioned upon the payment of the deficiency, interest, and additional amounts assessed in connection therewith in accordance with the terms of the extension granted, and shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds, and shall be subject to the approval of the Commissioner. In lieu of such a bond, the taxpayer may file a bond secured by deposit of Liberty bonds or other bonds or notes of the United States equal in their total par value to an amount not exceeding double the amount of the deficiency. (See section 1126 of the Revenue Act of 1926.) The amount of the deficiency and additions thereto shall be paid on or before the expiration of the period of the extension without the necessity of notice and demand from the collector. Payment of the deficiency and additions thereto before the expiration of the extension will not relieve the taxpayer from paying the entire amount of interest provided for in the extension. (See section 296.)

SEC. 273. JEOPARDY ASSESSMENTS.

(a) Authority for making.—If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he shall immediately assess such deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) and notice and demand shall be made by the collector for the payment thereof.

(b) Deficiency letters.—If the jeopardy assessment is made before any notice in respect of the tax to which the jeopardy assessment relates has been mailed under section 272 (a), then the Commissioner shall mail a notice under such subsection within 60 days after the making of the assessment.

(c) **Amount assessable before decision of Board.**—The jeopardy assessment may be made in respect of a deficiency greater or less than that notice of which has been mailed to the taxpayer, despite the provisions of section 272 (f) prohibiting the determination of additional deficiencies, and whether or not the taxpayer has theretofore filed a petition with the Board of Tax Appeals. The Commissioner shall notify the Board of the amount of such assessment, if the petition is filed with the Board before the making of the assessment or is subsequently filed, and the Board shall have jurisdiction to redetermine the entire amount of the deficiency and of all amounts assessed at the same time in connection therewith.

(d) **Amount assessable after decision of Board.**—If the jeopardy assessment is made after the decision of the Board is rendered such assessment may be made only in respect of the deficiency determined by the Board in its decision.

(e) **Expiration of right to assess.**—A jeopardy assessment may not be made after the decision of the Board has become final or after the taxpayer has filed a petition for review of the decision of the Board.

(f) **Bond to stay collection.**—When a jeopardy assessment has been made the taxpayer, within 10 days after notice and demand from the collector for the payment of the amount of the assessment, may obtain a stay of collection of the whole or any part of the amount of the assessment by filing with the collector a bond in such amount, not exceeding double the amount as to which the stay is desired, and with such sureties, as the collector deems necessary, conditioned upon the payment of so much of the amount, the collection of which is stayed by the bond, as is not abated by a decision of the Board which has become final, together with interest thereon as provided in section 297.

(g) **Same—Further conditions.**—If the bond is given before the taxpayer has filed his petition with the Board under section 272 (a), the bond shall contain a further condition that if a petition is not filed within the period provided in such subsection, then the amount the collection of which is stayed by the bond will be paid on notice and demand at any time after the expiration of such period, together with interest thereon at the rate of 6 per centum per annum from the date of the jeopardy notice and demand to the date of notice and demand under this subsection.

(h) **Waiver of stay.**—Upon the filing of the bond the collection of so much of the amount assessed as is covered by the bond shall be stayed. The taxpayer shall have the right to waive such stay at any time in respect of the whole or any part of the amount covered by the bond, and if as a result of such waiver any part of the amount covered by the bond is paid, then the bond shall, at the request of the taxpayer, be proportionately reduced. If the Board determines that the amount assessed is greater than the amount which should have been assessed, then when the decision of the Board is rendered the bond shall, at the request of the taxpayer, be proportionately reduced.

(i) **Collection of unpaid amounts.**—When the petition has been filed with the Board and when the amount which should have been assessed has been determined by a decision of the Board which has become final, then any unpaid portion, the collection of which has been stayed by the bond, shall be collected as part of the tax upon notice and demand from the collector, and any remaining portion of the assessment shall be abated. If the amount already collected exceeds the amount determined as the amount which should have been assessed, such excess shall be credited or refunded to the taxpayer as provided in section 322, without the filing of claim therefor. If the amount determined as the amount which should have been assessed is greater than the amount actually assessed, then the difference shall be assessed and shall be collected as part of the tax upon notice and demand from the collector.

(j) **Claims in abatement.**—No claim in abatement shall be filed in respect of any assessment in respect of any tax imposed by this title.

ART. 1181. **Jeopardy assessments.**—If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, he is required to assess such deficiency immediately, together with the interest and other additional amounts provided by law. If a deficiency is assessed on account of jeopardy after the decision of the Board of Tax Appeals is rendered, the jeopardy assessment may be made only with respect to the deficiency determined by the Board. The Commissioner is prohibited from making a jeopardy assessment after a decision of the Board has become final (see section 1005 of the Revenue Act of 1926) or after the taxpayer has filed a petition for review of the decision of the Board.

If notice of a deficiency was mailed to the taxpayer (see section 272 (a) and article 1171) before it was discovered that delay would jeopardize the assessment or collection of the tax, a jeopardy assessment may be made in an amount greater or less than that included in the deficiency notice. On the other hand if the assessment on account of jeopardy was made without mailing the notice required by section 272 (a), the Commissioner must within 60 days after the making of the assessment send the taxpayer notice of the deficiency by registered mail. The taxpayer may file a petition with the Board for a redetermination of the amount of the deficiency within 60 days (not counting Sunday as the sixtieth day) after such notice is mailed. If the petition of the taxpayer is filed with the Board, either before or after the making of the jeopardy assessment, the Commissioner is required to notify the Board of such assessment, and the Board has jurisdiction to redetermine the amount of the deficiency together with all other amounts assessed at the same time in connection therewith. (See section 273 (c).)

After a jeopardy assessment has been made, the list showing such assessment will be immediately transmitted to the collector. Upon receipt of the list containing the assessment, the collector is required to send notice and demand to the taxpayer for the amount of the

jeopardy assessment. Regardless of whether the taxpayer has filed a petition with the Board, he is required to make payment of the amount of such assessment within 10 days after the sending of notice and demand by the collector, unless before the expiration of such 10-day period he files with the collector a bond on Form 1129 of the character hereinafter prescribed. The bond must be in such amount, not exceeding double the amount for which the stay is desired, as the collector deems necessary and must be executed by sureties satisfactory to the collector. It must be conditioned upon the payment of so much of the amount included therein as is not abated by a decision of the Board which has become final, together with the interest on such amount provided for in section 297. If the bond is given before the taxpayer has filed his petition with the Board, it must contain a further condition that if a petition is not filed before the expiration of the 60-day period provided for the filing of such petition, the amount stayed by the bond will be paid upon notice and demand at any time after the expiration of such period, together with interest thereon at the rate of 6 per cent per annum from the date of the jeopardy notice and demand to the date of the notice and demand made after the expiration of the 60-day period. If a petition is not filed with the Board within the 60-day period, the collector will be so advised, and, if collection of the deficiency has been stayed by the filing of a bond within 10 days after the date of jeopardy notice and demand, he should then give notice and make demand for payment of the amount assessed plus interest. Any bond filed after the expiration of 10 days from the date of the jeopardy notice and demand is not such a bond as is contemplated by section 273 (f), and, while the collector may in his discretion accept the bond and stay collection of the deficiency, the taxpayer will not be relieved from payment of interest on the amount of the deficiency at the rate of 1 per cent a month from the date of the jeopardy notice and demand to the date of payment.

Upon the filing of a bond of the character described within 10 days after the date of notice and demand for payment of the amount assessed, the collection of so much thereof as is covered by the bond will be stayed. The taxpayer may at any time waive the stay of collection of the whole or any part of the amount covered by the bond. If as a result of such waiver any part of the amount covered by the bond is paid, then the bond will at the request of the taxpayer be proportionately reduced. If the Board determines that the amount assessed is greater than the correct amount of the tax, the

bond will also be proportionately reduced at the request of the taxpayer after the Board renders its decision.

After the Board has rendered its decision and such decision has become final, the collector will be notified of the action taken. The collector will then send notice and demand for the unpaid portion of the amount determined by the Board, the collection of which has been stayed by the bond. The collector is required to include in the notice and demand for the unpaid portion, interest at the rate of 6 per cent per annum from the date of the jeopardy notice and demand to the date of the notice and demand referred to in this paragraph. If the amount of the jeopardy assessment is less than the amount determined by the Board, the difference, together with interest as provided in section 292, will be assessed, and collected as part of the tax upon notice and demand from the collector. If the amount included in the notice and demand made after the decision of the Board is not paid within 10 days after such notice and demand, there shall be collected as part of the tax, interest as provided in section 294 (b). If the amount of the jeopardy assessment is in excess of the amount determined by the Board, the unpaid portion of such excess will be abated. If any part of the excess amount has been paid, it will be credited or refunded to the taxpayer as provided in section 322. (See articles 1251–1257.)

As to bankruptcy and receivership cases, see sections 274 and 298 and articles 1191 and 1192.

ART. 1182. **Claims in abatement.**—Section 273 (j) prohibits the filing of claims for abatement by taxpayers in respect of any asssessment of income tax imposed by Title I of the Revenue Act of 1928. This provision does not prohibit the filing of claims in abatement by collectors. (See also articles 1251 and 1252.)

SEC. 274. BANKRUPTCY AND RECEIVERSHIPS.

(a) Immediate assessment.—Upon the adjudication of bankruptcy of any taxpayer in any bankruptcy proceeding or the appointment of a receiver for any taxpayer in any receivership proceeding before any court of the United States or of any State or Territory or of the District of Columbia, any deficiency (together with all interest, additional amounts, or additions to the tax provided for by law) determined by the Commissioner in respect of a tax imposed by this title upon such taxpayer shall, despite the restrictions imposed by section 272 (a) upon assessments be immediately assessed if such deficiency has not theretofore been assessed in accordance with law. Claims for the deficiency and such interest, additional amounts and additions to the tax may be presented, for adjudication in accordance with law, to the court before which the bankruptcy or receivership proceeding is pending, despite the pendency of proceedings for the redetermination of the defi-

ciency in pursuance of a petition to the Board; but no petition for any such redetermination shall be filed with the Board after the adjudication of bankruptcy or the appointment of the receiver.

(b) **Unpaid claims.**—Any portion of the claim allowed in such bankruptcy or receivership proceeding which is unpaid shall be paid by the taxpayer upon notice and demand from the collector after the termination of such proceeding, and may be collected by distraint or proceeding in court within six years after termination of such proceeding. Extensions of time for such payment may be had in the same manner and subject to the same provisions and limitations as are provided in section 272 (j) and section 297 in the case of a deficiency in a tax imposed by this title.

ART. 1191. **Bankruptcy and receiverships.**—During bankruptcy proceedings in Federal courts under the National Bankruptcy Act of 1898, as amended, or during equity receivership proceedings in either Federal or State courts, the court making the adjudication of bankruptcy or appointing a receiver for any taxpayer has control over the assets of such taxpayer, and the collection of taxes due can not be made by distraining while the bankruptcy or receivership proceeding is pending.

Collectors should, promptly after notice of outstanding liability against a taxpayer in bankruptcy or in receivership, file claim in the appropriate court whether unpaid taxes involved have been assessed or not, except in cases where departmental instructions direct otherwise; for example, where taxes of the bankrupt or insolvent taxpayer are secured by a sufficient bond.

Under sections 3466 and 3467 of the Revised Statutes and section 64 (a) of the National Bankruptcy Act taxes take priority over claims of general creditors in cases of bankruptcy, receivership, and insolvency, and the trustee, receiver, or assignee may be held personally liable for failure on his part to protect the priority of the Government respecting taxes of which he has notice. Bankruptcy courts have complete jurisdiction under section 64 (a) of the National Bankruptcy Act to determine all disputes regarding the amount and validity of taxes of a bankrupt. Bankruptcy and receivership proceedings do not foreclose or discharge any portion of a claim of the United States for taxes which has been allowed by the court having jurisdiction over same and which remains unsatisfied after termination of the bankruptcy or receivership proceeding.

ART. 1192. **Immediate assessments in bankruptcy and receivership cases.**—Where the Commissioner has determined that a deficiency is due in respect of income tax and the taxpayer has filed a petition with the Board of Tax Appeals prior to adjudication of bankruptcy or the appointment of a receiver, the trustee or receiver appointed

by the court may prosecute the taxpayer's appeal before the Board as to that particular determination. In no case shall a petition be filed with the Board for a redetermination of the deficiency after the adjudication of bankruptcy or the appointment of a receiver.

Claim for the amount of a deficiency where properly before the Board for consideration may be filed with the bankruptcy or equity court without awaiting final decision of the Board. In case of final decision of the Board before determination of the bankruptcy or receivership proceeding, a copy of the Board's decision may be filed by the Commissioner with the bankruptcy or equity court.

While the Commissioner is required by section 274 to make immediate assessment of any deficiency, such assessment is not a jeopardy assessment within the meaning of section 273, and consequently the provisions of that section do not apply to any assessment made under section 274. Therefore, the notice of the deficiency provided for in section 273 (b) will not be mailed. Although such notice will not be issued, nevertheless a letter will be sent to the taxpayer or to the trustee or receiver in the bankruptcy or receivership proceeding, advising him in detail how the deficiency was computed, that the deficiency was assessed under the provisions of section 274, that he may furnish evidence showing wherein the assessment is incorrect, and that upon request he will be granted a hearing with respect to such assessment. If after such evidence is submitted and hearing held any adjustment appears necessary in the assessment, appropriate action will be taken looking to the submission of an amended claim in bankruptcy or receivership. A copy of the notification letter will be attached to the assessment list as the collector's authority for filing claim in bankruptcy or receivership for the amount represented by the assessment, plus interest at the rate of 6 per cent per annum for the period from the date of filing claim by the collector to the date of termination of the bankruptcy or receivership proceeding, or to the date of payment if payment is made in full prior to such termination. At the same time claim is filed with the bankruptcy or receivership court, the collector will send notice and demand for payment to the taxpayer together with a copy of such claim.

If any portion of the claim allowed by the court in a bankruptcy or a receivership proceeding remains unpaid after the termination of such proceeding, the collector will send notice and demand for payment thereof to the taxpayer. Such unpaid portion with interest as provided in section 298 may be collected from the taxpayer by distraint or proceeding in court within six years after the termination of the proceeding in bankruptcy or receivership. Extensions of time

for the payment of such unpaid amount may be granted in the same manner and subject to the same provisions and limitations as provided in sections 272 (j) and 297 in the case of a deficiency in a tax imposed by Title I. (See article 1173.)

This article deals only with immediate assessments provided for in section 274 and the procedure in connection with such assessments.

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) **General rule.**—The amount of income taxes imposed by this title shall be assessed within two years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

(b) **Request for prompt assessment.**—In the case of income received during the lifetime of a decedent, or by his estate during the period of administration, or by a corporation, the tax shall be assessed, and any proceeding in court without assessment for the collection of such tax shall be begun, within one year after written request therefor (filed after the return is made) by the executor, administrator, or other fiduciary representing the estate of such decedent, or by the corporation, but not after the expiration of two years after the return was filed. This subsection shall not apply in the case of a corporation unless—

(1) Such written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such year; and

(2) The dissolution is in good faith begun before the expiration of such year; and

(3) The dissolution is completed.

(c) **Corporation and shareholder.**—If a corporation makes no return of the tax imposed by this title, but each of the shareholders includes in his return his distributive share of the net income of the corporation, then the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed.

SEC. 276. SAME—EXCEPTIONS.

(a) **False return or no return.**—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

(b) **Waivers.**—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(c) **Collection after assessment.**—Where the assessment of any income tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court, but only if begun (1) within six years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such six-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

SEC. 277. SUSPENSION OF RUNNING OF STATUTE.

The running of the statute of limitations provided in section 275 or 276 on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall (after the mailing of a notice under section 272 (a)) be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter.

ART. 1201. **Period of limitation upon assessment of tax.**—The amount of income tax imposed by the Revenue Act of 1928 must be assessed within two years after the return was filed. Exceptions to the period of limitation stated in this paragraph are as follows:

(1) In the case of income received during the lifetime of a decedent or by his estate during the period of administration, or by a corporation contemplating dissolution, the tax shall be assessed within one year after written request therefor by the fiduciary or legal representative of the estate of the decedent or by the corporation. The effect of this provision is to limit the period in which the Commissioner may assess the tax in such cases to a period of one year from the date the request is filed, even though more than one year still remains of the regular two-year period in which the assessment may under ordinary circumstances be made. The request, in order to be effective, must be made after the return is filed and must be in such language as to make it clear to the Commissioner that it is desired to take advantage of the provisions of section 275 (b). In the case of a corporation the one-year period of limitation shall not apply unless—

(*a*) the written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such period,

(*b*) the dissolution is in good faith begun before the expiration of such period, and

(*c*) the dissolution so begun is completed either before or after the expiration of such year.

Such a request does not have the effect of extending the regular period of limitation even though the request is made less than one year before the expiration of the regular period of limitation.

(2) If a corporation makes no return of the tax imposed by Title I for the year 1928 or a subsequent year, but each of the shareholders includes in his personal return his distributive share of the net income of the corporation, the tax of the corporation shall be assessed within four years after the last date on which any such shareholder's return was filed.

(3) In the case of a false or fraudulent return with intent to evade tax, the tax may be assessed at any time after such false or fraudulent return is filed.

(4) In the event the taxpayer fails to file a return, the amount of tax due may be assessed at any time after the date prescribed for filing the return. (But see paragraph (2) of this article.)

(5) If before the expiration of the time prescribed in section 275 for the assessment of the tax the Commissioner and the taxpayer have consented in writing to the assessment of the tax after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

(6) If a notice of a deficiency has been mailed to the taxpayer under the provisions of section 272 (a) (see article 1171), then the running of the statute of limitations on assessment of any deficiency (the two-year period, the one-year period, the four-year period, or the period agreed upon in writing by the Commissioner and the taxpayer as provided in section 276 (b), as the case may be) shall be suspended for the period during which the Commissioner is prohibited from making the assessment (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter.

With respect to the period of limitation for assessing the amount of the liability of a transferee of property, or for assessing the amount of the liability of a fiduciary under section 3467 of the Revised Statutes, see section 311 and article 1231.

ART. 1202. **Period of limitation upon collection of tax.**—In the case of the tax imposed by Title I of the Revenue Act of 1928, a proceeding in court without assessment for the collection of such tax must be begun within two years after the return was filed.

The exceptions to the period of limitation upon collection of the tax without assessment stated in the preceding paragraph are as follows:

(1) In the case of income received during the lifetime of a decedent or by his estate during the period of administration, or by a corporation, a proceeding in court for the collection of the tax without assessment must be begun within one year after a written request therefor by the executor, administrator, or other fiduciary representing the estate of the decedent or by the corporation. Such a request does not have the effect of extending the regular period of limitation within which a proceeding in court without assessment may be begun, even though the request is made less than one year before the expiration of the regular period of limitation, nor is it of any effect if made before the return is filed. In the case of a corporation the conditions stated in (*a*), (*b*), and (*c*) of paragraph (1) of article 1201 also must be met.

(2) A proceeding in court for the collection of the tax without assessment may be begun at any time—

(*a*) In case the taxpayer files a false or fraudulent return with intent to evade tax; and

(*b*) In case the taxpayer failed to file a return.

In any case in which the tax has been assessed within the statutory period of limitation properly applicable thereto, a proceeding in court or distraint for the collection of such tax may be begun within six years after the assessment thereof, or prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such six-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon. In determining the running of the statute of limitations in respect of distraint, the distraint shall be held to have been begun, in the case of personal property, on the date on which the levy upon such property is made, or, in the case of real property, on the date on which notice of the time and place of sale is given to the person whose estate it is proposed to sell.

If a notice of a deficiency has been mailed to the taxpayer under the provisions of section 272 (a) (see article 1171), then the running of the statute of limitations on the beginning of distraint after assessment, or on the beginning of a proceeding in court after assessment or without assessment, in respect of any deficiency, shall be suspended for the period during which the Commissioner is prohibited from beginning such distraint or proceeding in court (and in any event, if

a proceeding in respect of the deficiency is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter.

SUPPLEMENT M—INTEREST AND ADDITIONS TO THE TAX

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file a return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, 25 per centum of the tax shall be added to the tax, except that when a return is filed after such time and it is shown that the failure to file it was due to reasonable cause and not due to willful neglect no such addition shall be made to the tax. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

ART. 1211. **Addition to the tax in case of failure to file return.**—In case of failure to make and file a return required by Title I within the prescribed time, 25 per cent of the amount of the tax is added to the tax unless the return is later filed and failure to file the return within the prescribed time is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect. Two classes of delinquents are subject to this addition to the tax:

(*a*) Those who do not file returns and for whom returns are made by a collector or the Commissioner, and

(*b*) Those who file tardy returns and are unable to show reasonable cause for the delay.

A taxpayer who files a tardy return and wishes to avoid the addition to the tax must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit which should be attached to the return. If such an affidavit is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the Commissioner, will forward the affidavit with the return, and, if the Commissioner determines that the delinquency was due to a reasonable cause and not to willful neglect, the 25 per cent addition to the tax will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return in the prescribed time, then the delay is due to reasonable cause.

Where the 25 per cent addition to the tax for delinquency in filing the return has been added, the amount so added shall be collected in the same manner as the tax.

For addition to the tax in case of a deficiency due to fraud with intent to evade tax, see section 293. As to the making of returns for taxpayers by collectors or the Commissioner in the case of delinquency in filing a return, or in the case of a false or fraudulent return, see section 3176 of the Revised Statutes, as amended by section 1103 of the Revenue Act of 1926 and by section 619 of the Revenue Act of 1928.

SEC. 292. INTEREST ON DEFICIENCIES.

Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per centum per annum from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed, or, in the case of a waiver under section 272 (d), to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed whichever is the earlier.

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

(a) **Negligence.**—If any part of any deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per centum of the total amount of the deficiency (in addition to such deficiency) shall be assessed, collected, and paid in the same manner as if it were a deficiency, except that the provisions of section 272 (i), relating to the prorating of a deficiency, and of section 292, relating to interest on deficiencies, shall not be applicable.

(b) **Fraud.**—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

SEC. 294. ADDITIONS TO THE TAX IN CASE OF NONPAYMENT.

(a) **Tax shown on return.**—

(1) GENERAL RULE.—Where the amount determined by the taxpayer as the tax imposed by this title, or any installment thereof, or any part of such amount or installment, is not paid on or before the date prescribed for its payment, there shall be collected as a part of the tax, interest upon such unpaid amount at the rate of 1 per centum a month from the date prescribed for its payment until it is paid.

(2) IF EXTENSION GRANTED.—Where an extension of time for payment of the amount so determined as the tax by the taxpayer, or any installment thereof, has been granted, and the amount the time for payment of which has been extended, and the interest thereon determined under section 295, is not paid in full prior to the expiration of the period of the extension, then, in lieu of the interest provided for in paragraph (1) of this subsection, interest at the rate of 1 per centum a month shall be collected on such

unpaid amount from the date of the expiration of the period of the extension until it is paid.

(b) **Deficiency.**—Where a deficiency, or any interest or additional amounts assessed in connection therewith under section 292, or under section 293, or any addition to the tax in case of delinquency provided for in section 291, is not paid in full within ten days from the date of notice and demand from the collector, there shall be collected as part of the tax, interest upon the unpaid amount at the rate of 1 per centum a month from the date of such notice and demand until it is paid. If any part of a deficiency prorated to any unpaid installment under section 272 (i) is not paid in full on or before the date prescribed for the payment of such installment, there shall be collected as part of the tax interest upon the unpaid amount at the rate of 1 per centum a month from such date until it is paid.

(c) **Fiduciaries.**—For any period an estate is held by a fiduciary appointed by order of any court of competent jurisdiction or by will, there shall be collected interest at the rate of 6 per centum per annum in lieu of the interest provided in subsections (a) and (b) of this section.

(d) **Filing of jeopardy bond.**—If a bond is filed, as provided in section 273, the provisions of subsections (b) and (c) of this section shall not apply to the amount covered by the bond.

SEC. 295. TIME EXTENDED FOR PAYMENT OF TAX SHOWN ON RETURN.

If the time for payment of the amount determined as the tax by the taxpayer, or any installment thereof, is extended under the authority of section 56 (c), there shall be collected as a part of such amount, interest thereon at the rate of 6 per centum per annum from the date when such payment should have been made if no extension had been granted, until the expiration of the period of the extension.

SEC. 296. TIME EXTENDED FOR PAYMENT OF DEFICIENCY.

If the time for the payment of any part of a deficiency is extended, there shall be collected, as a part of the tax, interest on the part of the deficiency the time for payment of which is so extended, at the rate of 6 per centum per annum for the period of the extension, and no other interest shall be collected on such part of the deficiency for such period. If the part of the deficiency the time for payment of which is so extended is not paid in accordance with the terms of the extension, there shall be collected, as a part of the tax, interest on such unpaid amount at the rate of 1 per centum a month for the period from the time fixed by the terms of the extension for its payment until it is paid, and no other interest shall be collected on such unpaid amount for such period.

SEC. 297. INTEREST IN CASE OF JEOPARDY ASSESSMENTS.

In the case of the amount collected under section 273 (i) there shall be collected at the same time as such amount, and as a part of the tax, interest at the rate of 6 per centum per annum upon such amount from the date of the jeopardy notice and demand to the date of notice and

demand under section 273 (i), or, in the case of the amount collected in excess of the amount of the jeopardy assessment, interest as provided in section 292. If the amount included in the notice and demand from the collector under section 273 (i) is not paid in full within ten days after such notice and demand, then there shall be collected, as part of the tax, interest upon the unpaid amount at the rate of 1 per centum a month (or, for any period the estate of the taxpayer is held by a fiduciary appointed by any court of competent jurisdiction or by will, at the rate of 6 per centum per annum) from the date of such notice and demand until it is paid.

SEC. 298. BANKRUPTCY AND RECEIVERSHIPS.

If the unpaid portion of the claim allowed in a bankruptcy or receivership proceeding, as provided in section 274, is not paid in full within 10 days from the date of notice and demand from the collector, then there shall be collected as a part of such amount interest upon the unpaid portion thereof at the rate of 1 per centum a month from the date of such notice and demand until payment.

SEC. 299. REMOVAL OF PROPERTY OR DEPARTURE FROM UNITED STATES.

For additions to tax in case of leaving the United States or concealing property in such manner as to hinder collection of the tax, see section 147.

SUPPLEMENT N—CLAIMS AGAINST TRANSFEREES AND FIDUCIARIES

SEC. 311. TRANSFERRED ASSETS.

(a) **Method of collection.**—The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) TRANSFEREES.—The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this title.

(2) FIDUCIARIES.—The liability of a fiduciary under section 3467 of the Revised Statutes in respect of the payment of any such tax from the estate of the taxpayer.

Any such liability may be either as to the amount of tax shown on the return or as to any deficiency in tax.

(b) **Period of limitation.**—The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer,—within one year after the expiration of the period of limitation for assessment against the taxpayer;

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(2) In the case of the liability of a transferee of a transferee of the property of the taxpayer,—within one year after the expiration of the period of limitation for assessment against the preceding transferee, but only if within three years after the expiration of the period of limitation for assessment against the taxpayer;

except that if before the expiration of the period of limitation for the assessment of the liability of the transferee, a court proceeding for the collection of the tax or liability in respect thereof has been begun against the taxpayer or last preceding transferee, respectively,—then the period of limitation for assessment of the liability of the transferee shall expire one year after the return of execution in the court proceeding.

(3) In the case of the liability of a fiduciary,—not later than one year after the liability arises or not later than the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later.

(c) Period for assessment against taxpayer.—For the purposes of this section, if the taxpayer is deceased, or in the case of a corporation, has terminated its existence, the period of limitation for assessment against the taxpayer shall be the period that would be in effect had the death or termination of existence not occurred.

(d) Suspension of running of statute of limitations.—The running of the statute of limitations upon the assessment of the liability of a transferee or fiduciary shall, after the mailing to the transferee or fiduciary of the notice provided for in section 272 (a), be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter.

(e) Address for notice of liability.—In the absence of notice to the Commissioner under section 312 (b) of the existence of a fiduciary relationship, notice of liability enforceable under this section in respect of a tax imposed by this title, if mailed to the person subject to the liability at his last known address, shall be sufficient for the purposes of this title even if such person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

(f) Definition of "transferee."—As used in this section, the term "transferee" includes, heir, legatee, devisee, and distributee.

ART. 1231. **Claims in cases of transferred assets.**—The amount for which a transferee of the property of a taxpayer is liable, at law or in equity, and the amount of the personal liability of a fiduciary under section 3467 of the Revised Statutes, in respect of any income tax imposed by Title I of the Revenue Act of 1928, whether shown on the return of the taxpayer or determined as a deficiency in the tax, shall be assessed against such transferee or such fiduciary, as the case may be, and collected and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by Title I of the Revenue Act of 1928, except as hereinafter

provided. The provisions relating to delinquency in payment after notice and demand and the amount of interest attaching because of such delinquency, the authorization of distraint and proceedings in court for collection, the prohibition of claims for abatement and claims and suits for refund, the filing of a petition with the Board of Tax Appeals, and the filing of a petition for review of the Board's decision, are included in the sections and articles relating to deficiencies in tax imposed by Title I.

The term "transferee" as used in this article includes an heir, legatee, devisee, distributee of an estate of a deceased person, the shareholder of a dissolved corporation, the assignee or donee of an insolvent person, the successor of a corporation, a party to a reorganization as defined in section 112, and all other classes of distributees.

The period of limitation for assessment of the liability of a transferee or of a fiduciary, referred to in the first paragraph of this article, is as follows:

(1) In the case of the liability of an initial transferee of the property of the taxpayer one year after the expiration of the period of limitation for assessment against the taxpayer (see sections 275–277 and articles 1201 and 1202);

(2) In the case of the liability of a transferee of a transferee of the property of the taxpayer, one year after the expiration of the period of limitation for assessment against the preceding transferee, or three years after the expiration of the period of limitation for assessment against the taxpayer, whichever of the two periods (the one-year period or the three-year period) first expires;

(3) If a court proceeding against the taxpayer or last preceding transferee for the collection of the tax or liability in respect thereof, respectively, has been begun within the period of limitation for the bringing of such proceeding, then within one year after the return of execution in such proceeding; and

(4) In the case of the liability of a fiduciary, not later than one year after the liability arises or not later than the expiration of the period for collection of the tax in respect of which such liability arises, whichever is the later.

For the purpose of determining the period of limitation for assessment against a transferee or a fiduciary, if the taxpayer is deceased, or, in the case of a corporation, has terminated its existence, the period of limitation for assessment against the taxpayer shall be the period that would be in effect had the death or termination of existence not occurred.

If a notice of the liability of a transferee or the liability of a fiduciary has been mailed to such transferee or to such fiduciary

under the provisions of section 272 (a) (see article 1171), then the running of the statute of limitations shall be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter.

SEC. 312. NOTICE OF FIDUCIARY RELATIONSHIP.

(a) **Fiduciary of taxpayer.**—Upon notice to the Commissioner that any person is acting in a fiduciary capacity such fiduciary shall assume the powers, rights, duties, and privileges of the taxpayer in respect of a tax imposed by this title (except as otherwise specifically provided and except that the tax shall be collected from the estate of the taxpayer), until notice is given that the fiduciary capacity has terminated.

(b) **Fiduciary of transferee.**—Upon notice to the Commissioner that any person is acting in a fiduciary capacity for a person subject to the liability specified in section 311, the fiduciary shall assume, on behalf of such person, the powers, rights, duties, and privileges of such person under such section (except that the liability shall be collected from the estate of such person), until notice is given that the fiduciary capacity has terminated.

(c) **Manner of notice.**—Notice under subsection (a) or (b) shall be given in accordance with regulations prescribed by the Commissioner with the approval of the Secretary.

ART. 1241. **Fiduciaries.**—As soon as the Commissioner receives notice that a person is acting in a fiduciary capacity, such fiduciary must, except as otherwise specifically provided, assume the powers, rights, duties, and privileges of the taxpayer with respect to the tax imposed by Title I of the Revenue Act of 1928. If the person is acting as a fiduciary for a transferee or other person subject to the liability specified in section 311 (see article 1231), such fiduciary is required to assume the powers, rights, duties, and privileges of the transferee or other person under that section. The amount of the tax or liability is, however, not collectible from the personal estate of the fiduciary but is collectible from the estate of the taxpayer or from the estate of the transferee or other person subject to the liability specified in section 311. The "notice to the Commissioner" provided for in section 312 shall be a written notice signed by the fiduciary and filed with the Commissioner. The notice must state the name and address of the person for whom the fiduciary is acting, and the nature of the liability of such person; that is, whether it is a liability for tax, and, if so, the year or years involved, or a liability

at law or in equity of a transferee of property of a taxpayer, or a liability of a fiduciary under section 3467 of the Revised Statutes in respect of the payment of any tax from the estate of the taxpayer. Any such written notice which has been filed with the Commissioner since the enactment of the Revenue Act of 1926 shall be considered as sufficient notice to the Commissioner within the meaning of section 312. Unless there is already on file with the Commissioner satisfactory evidence of the authority of the fiduciary to act for such person in a fiduciary capacity, such evidence must be filed with and made a part of the notice. If the fiduciary capacity exists by order of court, a certified copy of the order may be regarded as such satisfactory evidence. When the fiduciary capacity has terminated, the fiduciary in order to be relieved of any further duty or liability as such, must file with the Commissioner written notice that the fiduciary capacity has terminated as to him, accompanied by satisfactory evidence of the termination of the fiduciary capacity. The notice of termination should state the name and address of the person, if any, who has been substituted as fiduciary.

If the notice of the fiduciary capacity described in the preceding paragraph is not filed with the Commissioner prior to the sending of notice of a deficiency by registered mail to the last known address of the taxpayer (see section 272 (a)), or the last known address of the transferee or other person subject to liability (see section 311), no notice of the deficiency will be sent to the fiduciary. In such a case the sending of the notice to the last known address of the taxpayer, transferee, or other person, as the case may be, will be a sufficient compliance with the requirements of the Act, even though such taxpayer, transferee, or other person is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence. Under such circumstances if no petition is filed with the Board of Tax Appeals before the expiration of 60 days from the sending of the notice to the taxpayer, transferee, or other person, the tax, or liability under section 311, will be assessed immediately upon the expiration of such 60-day period, and demand for payment will be made by the collector. The term fiduciary is defined in section 701 (a) (5) to mean a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

This article, relating to the provisions of section 312, shall not be taken to abridge in any way the powers and duties of fiduciaries provided for in other sections of Title I of the Revenue Act of 1928.

SUPPLEMENT O—OVERPAYMENTS

SEC. 321. OVERPAYMENT OF INSTALLMENT.

If the taxpayer has paid as an installment of the tax more than the amount determined to be the correct amount of such installment, the overpayment shall be credited against the unpaid installments, if any. If the amount already paid, whether or not on the basis of installments, exceeds the amount determined to be the correct amount of the tax, the overpayment shall be credited or refunded as provided in section 322.

SEC. 322. REFUNDS AND CREDITS.

(a) Authorization.—Where there has been an overpayment of any tax imposed by this title, the amount of such overpayment shall be credited against any income, war-profits, or excess-profits tax or installment thereof then due from the taxpayer, and any balance shall be refunded immediately to the taxpayer.

(b) Limitation on allowance.—

(1) PERIOD OF LIMITATION.—No such credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer.

(2) LIMIT ON AMOUNT OF CREDIT OR REFUND.—The amount of the credit or refund shall not exceed the portion of the tax paid during the two years immediately preceding the filing of the claim, or if no claim was filed, then during the two years immediately preceding the allowance of the credit or refund.

(c) Effect of petition to Board.—If the Commissioner has mailed to the taxpayer a notice of deficiency under section 272 (a) and if the taxpayer files a petition with the Board of Tax Appeals within the time prescribed in such subsection, no credit or refund in respect of the tax for the taxable year in respect of which the Commissioner has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court except—

(1) As to overpayments determined by a decision of the Board which has become final; and

(2) As to any amount collected in excess of an amount computed in accordance with the decision of the Board which has become final; and

(3) As to any amount collected after the period of limitation upon the beginning of distraint or a proceeding in court for collection has expired; but in any such claim for credit or refund or in any such suit for refund the decision of the Board which has become final, as to whether such period has expired before the notice of deficiency was mailed, shall be conclusive.

(d) Overpayment found by Board.—If the Board finds that there is no deficiency and further finds that the taxpayer has made an overpayment of tax in respect of the taxable year in respect of which the Commissioner determined the deficiency, the Board shall have jurisdiction to determine the amount of such overpayment, and such

amount shall, when the decision of the Board has become final, be credited or refunded to the taxpayer. No such credit or refund shall be made of any portion of the tax paid more than two years before the filing of the claim or the filing of the petition, whichever is earlier.

(e) Tax withheld at source.—For refund or credit in case of excessive withholding at the source, see section 144 (f).

ART. 1251. **Authority for abatement, credit, and refund of tax.**—Authority for the credit and refund of any overpayment of any income tax imposed by the Revenue Act of 1928 is contained in section 322.

Section 273 (j) prohibits the filing of claims for abatement by taxpayers with respect to assessments of income tax imposed by Title I of the Revenue Act of 1928. (See article 1182.) The provisions of section 273 (j) do not impair the authority of the collectors to file claims with the Commissioner for relief from charges against them for uncollectible items, in accordance with section 3218 of the Revised Statutes, as amended, which provides:

> SEC. 3218. Every collector shall be charged with the whole amount of taxes, whether contained in lists transmitted to him by the Commissioner of Internal Revenue, or by other collectors, or delivered to him by his predecessor in office, and with the additions thereto, with the par value of all stamps deposited with him, and with all moneys collected for penalties, forfeitures, fees, or costs; and he shall be credited with all payments into the Treasury made as provided by law, with all stamps returned by him uncanceled to the Treasury, and with the amount of taxes contained in the lists transmitted in the manner heretofore provided to other collectors, and by them receipted as aforesaid; also with the amount of the taxes of such persons as may have absconded, or become insolvent, prior to the day when the tax ought, according to the provisions of law, to have been collected, and with all uncollected taxes transferred by him or by his deputy acting as collector to his successor in office: *Provided*, That it shall be proved to the satisfaction of the Commissioner of Internal Revenue, who shall certify the facts to the (First) Comptroller of the Treasury, that due diligence was used by the collector. And each collector shall also be credited with the amount of all property purchased by him for the use of the United States, provided he faithfully account for and pay over the proceeds thereof upon a resale of the same as required by law.

ART. 1252. **Abatement, credit, and refund adjustments.**—Overassessments and overpayments of income taxes will be adjusted by means of certificates of overassessment. Credits or refunds of overpayments on the basis of such certificates of overassessment may not be allowed or made, however, after the expiration of the statutory period of limitation properly applicable unless prior to the expiration of such period a claim therefor on Form 843 has been

filed by the taxpayer. The claim, together with appropriate supporting evidence, must be filed in the office of the collector for the district in which the tax was paid. Where an amount of tax in excess of that properly due has been paid by a withholding agent, the credit or refund of such excess amount shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent. (See section 144 (f).) As to interest in case of credits or refunds, see sections 614 and 615.

ART. 1253. **Claims by collectors.**—A collector may present blanket claims on Form 843 for the abatement of certain items which were erroneously assessed. Many of these items fall in a class where the error in assessment is apparent, and the abatement of such assessment by use of blanket claims serves to relieve the collector of the charge against him for such amounts and to relieve him in an expeditious manner of the duty of collecting from the taxpayer certain amounts which a summary examination clearly shows are not due from the taxpayer. Some of the items included in this class of cases are duplicate assessments, amounts assessed as unidentified collections and later identified, assessments resulting from errors in computation, and amounts assessed as excess collections which are subsequently credited against taxes later found to be due. The collector may include in such claims overassessments discovered by him in the audit of returns which he is authorized by the Commissioner to audit.

In the event any such assessment has been paid, the collector may file a blanket claim on Form 843 for credit of such amounts against any unpaid assessments standing against the taxpayer upon the assessment lists held by the collector. If there are no such unpaid assessments against which credit may be taken, the collector shall submit refund schedules to cover such amounts in accordance with instructions issued by the Commissioner. But no such credit or refund shall be allowed or made unless allowed or made within the statutory period of limitation properly applicable thereto.

The collector may also present claims for credit of taxes not erroneously assessed but found to be uncollectible. See section 3218 of the Revised Statutes, as amended. In such cases the collector or deputy collector who made the demand for payment and is conversant with the facts may prepare the claim for credit on Form 53. Even though the collector is so credited with the amount allowed as uncollectible, nevertheless the obligation to pay still remains upon the person assessed. It is the duty of the collector to use the same diligence to collect the tax after he has received credit for an amount as uncollectible as before the allowance of such credit. Collectors

should therefore keep a record of all taxes thus credited and of the persons from whom they are due and should enforce payment whenever it is in their power to do so.

ART. 1254.[1] **Claims for refund by taxpayers.**—Claims by the taxpayer for the refunding of taxes, interest, penalties, and additions to tax erroneously or illegally collected shall be made on Form 843. A separate claim on such form shall be made for each taxable year or period. All facts relied upon in support of the claim should be clearly set forth in detail under oath. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the executor, administrator, or other fiduciary by whom the claim is filed. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter a refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made in the claim showing that the return was filed by the fiduciary and that the latter is still acting. In such cases, if a refund or interest is to be paid, letters testamentary, letters of administration, or other evidence may be required, but should be submitted only upon the receipt of a specific request therefor. If a claim is filed by a fiduciary other than the one by whom the return was filed, the necessary documentary evidence should accompany the claim. The affidavit may be made by the agent of the person assessed, but in such case a power of attorney must accompany the claim. Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and may be sent to such persons in care of an attorney or agent who has filed a power of attorney specifically authorizing him to receive such checks. The Commissioner may, however, send any such check direct to the claimant. In this connection, see section 3477 of the Revised Statutes, which provides:

> SEC. 3477. All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgments of deeds, and shall be certi-

[1] See T. Ds. 4265 and 4266, pp. 367–368.

filed by the taxpayer. The claim, together with appropriate supporting evidence, must be filed in the office of the collector for the district in which the tax was paid. Where an amount of tax in excess of that properly due has been paid by a withholding agent, the credit or refund of such excess amount shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent. (See section 144 (f).) As to interest in case of credits or refunds, see sections 614 and 615.

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In the event any such assessment has been paid, the collector may file a blanket claim on Form 843 for credit of such amounts against any unpaid assessments standing against the taxpayer upon the assessment lists held by the collector. If there are no such unpaid assessments against which credit may be taken, the collector shall submit refund schedules to cover such amounts in accordance with instructions issued by the Commissioner. But no such credit or refund shall be allowed or made unless allowed or made within the statutory period of limitation properly applicable thereto.

The collector may also present claims for credit of taxes not erroneously assessed but found to be uncollectible. See section 3218 of the Revised Statutes, as amended. In such cases the collector or deputy collector who made the demand for payment and is conversant with the facts may prepare the claim for credit on Form 53. Even though the collector is so credited with the amount allowed as uncollectible, nevertheless the obligation to pay still remains upon the person assessed. It is the duty of the collector to use the same diligence to collect the tax after he has received credit for an amount as uncollectible as before the allowance of such credit. Collectors

should therefore keep a record of all taxes thus credited and of the persons from whom they are due and should enforce payment whenever it is in their power to do so.

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[1] See T. Ds. 4265 and 4266, pp. 367–368.

fied by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgment, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same.

The Commissioner has no authority to refund on equitable grounds penalties or other amounts legally collected. As to claims for refund of sums recovered by suit, see articles 1255 and 1256.

ART. 1255. **Claims for refund in case of judgment obtained against collector.**—(*a*) Claims for the amount of a judgment against a collector of internal revenue for the recovery of taxes, penalties, or other sums should be made on Form 843 and filed with the Commissioner of Internal Revenue, Washington, D. C. The claimant should state the grounds of his claim under oath, giving the names of all the parties to the suit, the cause of action, the date of its commencement, the date of the judgment, the court in which it was recovered, and its amount. To this affidavit there should be annexed a certified copy of the final judgment in duplicate, a certificate of probable cause, and an itemized bill of the costs paid, receipted by the clerk or other proper officer of the court. In this connection section 989 of the Revised Statutes provides:

SEC. 989. When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury.

(*b*) If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name. A certificate of the clerk of the court in which the judgment was recovered (or other satisfactory evidence), showing that the judgment has been satisfied and specifying the exact sum paid in its satisfaction, with a detail of all items of costs which were paid by the judgment debtor or for which he is liable, should accompany the claim. (See further article 1254.)

ART. 1256.[1] **Claims for refund in case of judgment obtained against the United States.**—Claims for the amounts of judgments rendered by United States District Courts and the United States Court of Claims against the United States for the recovery of taxes, penalties, or other sums shall be made on Form 843 in the manner prescribed by

[1] See T. D. 4262, p. 368.

paragraph (*a*) of article 1255 in the case of judgments against collectors, except that—

(*a*) A certificate of probable cause is not required;

(*b*) The claims shall be executed in duplicate; and

(*c*) In the case of a judgment rendered by the Court of Claims there may be submitted, in place of a certified copy of the final judgment, a certificate of the judgment issued by the clerk of the court and two copies of the court's opinion, if any was rendered.

ART. 1257. **Limitations upon the crediting and refunding of taxes paid.**—(*a*) Except as provided in (*b*) of this article, (1) the Commissioner is prohibited from making credits or refunds of income tax imposed by the Revenue Act of 1928 after two years from the time the tax was paid unless before the expiration of such two-year period a claim therefor is filed, and (2) the amount of such credit or refund shall not exceed the portion of the tax paid during the two-year period immediately preceding the date of the allowance of the credit or refund, or, if the credit or refund is based upon a claim, the amount of the credit or refund shall not exceed the portion of the tax paid during the two-year period immediately preceding the date of filing such claim.

(*b*) In any case where a person having a right to file a petition with the Board of Tax Appeals with respect to a deficiency in income tax imposed by the Revenue Act of 1928 files such petition within the prescribed time, no credit or refund of the tax for the year to which the deficiency relates shall be allowed or made, and no suit for the recovery of any part of such tax shall be instituted by the taxpayer, except that—

(1) If the Board finds that there is no deficiency but that the person has overpaid his tax for the year to which the notice of deficiency relates, and the decision of the Board as to the amount overpaid has become final (see section 1005 of the Revenue Act of 1926), the overpayment shall be credited or refunded, but no such credit or refund shall be made of any portion of the tax paid more than two years before the filing of the refund claim therefor or the filing of the petition, whichever is earlier.

(2) In the case of a jeopardy assessment made under section 273, if the amount which should have been assessed as determined by a decision of the Board which has become final is less than the amount already collected, the excess payment shall be credited or refunded subject to the limitation provided in (*b*) (1) of this article.

(3) If the amount of the deficiency determined by the Board (in a case where collection has not been stayed by the filing of a bond)

is disallowed in whole or in part by the reviewing court, then the overpayment resulting from such disallowance shall be credited or refunded without the making of claim therefor. (See section 1001 (d) of the Revenue Act of 1926, as amended by section 603 of the Revenue Act of 1928.)

(4) Where the amount collected is in excess of the amount computed in accordance with the decision of the Board which has become final, the excess payment shall be credited or refunded within the period of limitation provided in section 322 (b).

(5) Where an amount is collected after the statutory period of limitation upon the beginning of distraint or a proceeding in court for collection has expired (see article 1202), the taxpayer may file a claim for refund of the amount so collected within the period of limitation provided in section 322 (b). In any such case, the decision of the Board as to whether the statutory period upon collection of the tax expired before notice of the deficiency was mailed shall, when the decision becomes final, be conclusive.

DIVISION IV—MISCELLANEOUS PROVISIONS

TITLE III—AMENDMENTS TO 1926 INCOME TAX

SEC. 501. AFFILIATED CORPORATIONS—STATUTE OF LIMITATIONS.

(a) Section 240 of the Revenue Act of 1926 is amended by adding at the end thereof a new subdivision to read as follows:

"(h) (1) If a notice under subdivision (a) of section 274 in respect of a deficiency for the taxable year 1922, 1923, 1924, 1925, 1926, or 1927, has been mailed to a corporation, the suspension of the running of the statute of limitations, provided in subdivision (b) of section 277 and in subdivision (1) of section 283, shall apply in the case of corporations with which such corporation made a consolidated return for such taxable year.

(2) If a notice under subdivision (a) of section 274 in respect of a deficiency for the taxable year 1921 or any previous taxable year has been mailed to a corporation, the suspension of the running of the statute of limitations provided in subdivision (b) of section 277 and in subdivision (1) of section 283, shall apply in the case of the corporations with which such corporation was affiliated, determined in accordance with the law applicable to the year in respect of which the deficiency is asserted."

(b) Subsection (a) of this section shall apply in all cases where the period of limitation has not expired prior to the enactment of this Act.

SEC. 502. EXTENSION OF TIME FOR PAYMENT OF DEFICIENCIES.

Section 274 (k) of the Revenue Act of 1926 is amended by striking out "may grant an extension for the payment of such deficiency or any part thereof for a period not in excess of 18 months" and inserting in lieu thereof "may grant an extension for the payment of such deficiency or any part thereof for a period not in excess of 18 months, and, in exceptional cases, for a further period not in excess of 12 months."

SEC. 503. REQUEST FOR PROMPT ASSESSMENT.

Section 277 (a) (4) of the Revenue Act of 1926 is amended to read as follows:

"(4) In the case of income received during the lifetime of a decedent, or by his estate during the period of administration, or by a corporation, the tax shall be assessed, and any proceeding in court without assessment for the collection of such tax shall be begun, within one year after written request therefor (filed after the return is made),

by the executor, administrator, or other fiduciary representing the estate of such decedent, or by the corporation, but not after the expiration of the period prescribed for the assessment of the tax in paragraph (1), (2), or (3) of this subdivision. This paragraph shall not apply in the case of a corporation unless (A) such written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such year; and (B) the dissolution is in good faith begun before the expiration of such year; and (C) the dissolution is completed; nor shall it apply in the case of income of a corporation or of an estate during the period of administration unless the written request is filed after the enactment of the Revenue Act of 1928."

SEC. 504. SUSPENSION OF RUNNING OF STATUTE OF LIMITATIONS.

(a) Section 277 (b) of the Revenue Act of 1926 is amended to read as follows:

"(b) The running of the statute of limitations provided in this section or in section 278 on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall (after the mailing of a notice under subdivision (a) of section 274) be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter."

(b) Subsection (a) of this section shall apply in all cases where the period of limitation has not expired prior to the enactment of this Act.

SEC. 505. SAME—TRANSFEREE CASES.

(a) Section 280 (d) of the Revenue Act of 1926 is amended to read as follows:

"(d) The running of the statute of limitations upon the assessment of the liability of a transferee or fiduciary shall, after the mailing of the notice under subdivision (a) of section 274 to the transferee or fiduciary, be suspended for the period during which the Commissioner is prohibited from making the assessment in respect of the liability of the transferee or fiduciary (and in any event, if a proceeding in respect of the liability is placed on the docket of the Board, until the decision of the Board becomes final), and for 60 days thereafter."

(b) Subsection (a) of this section shall apply in all cases where the period of limitation has not expired prior to the enactment of this Act.

SEC. 506. WAIVERS AFTER EXPIRATION OF PERIOD OF LIMITATION.

(a) Section 278 (c) and (d) of the Revenue Act of 1926 are amended to read as follows:

"(c) Where before the expiration of the time prescribed in section 277 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period

agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

"(d) Where the assessment of any income, excess-profits, or war-profits taxes imposed by this title or by prior Act of Congress has been made (whether before or after the enactment of this Act) within the period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court (begun before or after the enactment of this Act), but only if begun (1) within six years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer before the expiration of such six-year period. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon."

(b) Section 278 of the Revenue Act of 1926 is further amended by adding at the end thereof a new subdivision to read as follows:

"(f) Any agreement which would be within the provisions of subdivision (c) or (d) of this section but for the fact that it was executed after the expiration of the period of limitation extended by such agreement, shall be valid and effective according to its terms if entered into after the enactment of the Revenue Act of 1928 and before January 1, 1929."

(c) The amendments made by this section to the Revenue Act of 1926 shall not be construed as in any manner affecting the validity of waivers made prior to the enactment of this Act, which shall be determined according to the law in existence at the time such waiver was filed.

SEC. 507. OVERPAYMENTS FOUND BY BOARD OF TAX APPEALS.

Section 284 (e) of the Revenue Act of 1926 is amended to read as follows:

"(e) If the Board finds that there is no deficiency and further finds that the taxpayer has made an overpayment of tax in respect of the taxable year in respect of which the Commissioner determined the deficiency, the Board shall have jurisdiction to determine the amount of such overpayment, and such amount shall, when the decision of the Board has become final, be credited or refunded to the taxpayer as provided in subdivision (a). Unless claim for credit or refund, or the petition, was filed within the time prescribed in subdivision (g) for filing claims, no such credit or refund shall be made of any portion of the tax paid more than four years (or, in the case of a tax imposed by this title, more than three years) before the filing of the claim or the filing of the petition, whichever is earlier."

TITLE IV—ADMINISTRATIVE PROVISIONS

SEC. 601. BOARD OF TAX APPEALS—PROCEDURE.

Sections 906 and 907 (a) and (b) of the Revenue Act of 1924, as amended, are further amended to read as follows:

"SEC. 906. (a) The chairman may from time to time divide the Board into divisions of one or more members, assign the members of the

Board thereto, and in case of a division of more than one member, designate the chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than the number of members designated for the division, the chairman may assign other members to the division or direct the division to proceed with the transaction of business without awaiting any additional assignment of members thereto. A division shall hear, and make a determination upon, any proceeding instituted before the Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

"(b) The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Board except in accordance with such rules as the Board may prescribe. The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board.

"(c) If a petition for a redetermination of a deficiency has been filed by the taxpayer, a decision of the Board dismissing the proceeding shall be considered as its decision that the deficiency is the amount determined by the Commissioner. An order specifying such amount shall be entered in the records of the Board unless the Board can not determine such amount from the record in the proceeding, or unless the dismissal is for lack of jurisdiction.

"(d) A decision of the Board (except a decision dismissing a proceeding for lack of jurisdiction) shall be held to be rendered upon the date that an order specifying the amount of the deficiency is entered in the records of the Board. If the Board dismisses a proceeding for reasons other than lack of jurisdiction and is unable from the record to determine the amount of the deficiency determined by the Commissioner, or if the Board dismisses a proceeding for lack of jurisdiction, an order to that effect shall be entered in the records of the Board, and the decision of the Board shall be held to be rendered upon the date of such entry.

"(e) If the assessment or collection of any tax is barred by any statute of limitations, the decision of the Board to that effect shall be considered as its decision that there is no deficiency in respect of such tax.

"(f) The findings of the Board made in connection with any decision prior to the enactment of the Revenue Act of 1926 shall, notwithstanding the enactment of such Act, continue to be prima facie evidence of the facts therein stated.

"SEC. 907. (a) Notice and opportunity to be heard upon any proceeding instituted before the Board shall be given to the taxpayer and the Commissioner, and a report upon the proceeding and a decision thereon shall be made as quickly as practicable. The decision shall be made by a member in accordance with the report of the Board, and such decision so made shall, when entered, be the decision of the Board.

If an opportunity to be heard upon the proceeding is given before a division of the Board, neither the taxpayer nor the Commissioner shall be entitled to notice and opportunity to be heard before the Board upon review, except upon a specific order of the chairman. Hearings before the Board and its divisions shall be open to the public, and the testimony, and, if the Board so requires, the argument shall be stenographically reported. The Board is authorized to contract (by renewal of contract or otherwise) for the reporting of such hearings, and in such contract to fix the terms and conditions under which transcripts will be supplied by the contractor to the Board and to other persons and agencies. The proceedings of the Board and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Board may prescribe and in accordance with the rules of evidence applicable in courts of equity of the District of Columbia. In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, where no hearing has been held before the enactment of the Revenue Act of 1928, the burden of proof in respect of such issue shall be upon the Commissioner. The mailing by registered mail of any pleading, decision, order, notice, or process in respect of proceedings before the Board shall be held sufficient service of such pleading, decision, order, notice, or process.

"(b) It shall be the duty of the Board and of each division to include in its report upon any proceeding its findings of fact or opinion or memorandum opinion. The Board shall report in writing all its findings of fact, opinions and memorandum opinions."

SEC. 602. BOARD OF TAX APPEALS—TRANSFEREE PROCEEDINGS.

Title IX of the Revenue Act of 1924, as amended, is further amended by adding at the end thereof two new sections to read as follows:

"TRANSFEREE PROCEEDINGS

"SEC. 912. In proceedings before the Board the burden of proof shall be upon the Commissioner to show that a petitioner is liable as a transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax.

"SEC. 913. Upon application to the Board, a transferee of property of a taxpayer shall be entitled, under rules prescribed by the Board, to a preliminary examination of books, papers, documents, correspondence, and other evidence of the taxpayer or a preceding transferee of the taxpayer's property, if the transferee making the application is a petitioner before the Board for the redetermination of his liability in respect of the tax (including interest, penalties, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer. Upon such application the Board may require by subpœna, ordered by the Board or any division thereof and signed by a member, the production of all such books, papers, documents, correspondence, and other evidence within the United States the production of which, in the opinion of the Board or division thereof, is necessary to enable the transferee to ascertain the liability of the taxpayer or preceding trans-

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feree and will not result in undue hardship to the taxpayer or preceding transferee. Such examination shall be had at such time and place as may be designated in the subpœna."

SEC. 603. BOARD OF TAX APPEALS—COURT REVIEW OF DECISION.

Subdivisions (c) and (d) of section 1001 of the Revenue Act of 1926 are amended to read as follows:

"(c) Notwithstanding any provision of law imposing restrictions on the assessment and collection of deficiencies, such review shall not operate as a stay of assessment or collection of any portion of the amount of the deficiency determined by the Board unless a petition for review in respect of such portion is duly filed by the taxpayer, and then only if the taxpayer (1) on or before the time his petition for review is filed has filed with the Board a bond in a sum fixed by the Board not exceeding double the amount of the portion of the deficiency in respect of which the petition for review is filed, and with surety approved by the Board, conditioned upon the payment of the deficiency as finally determined, together with any interest, additional amounts, or additions to the tax provided for by law, or (2) has filed a jeopardy bond under the income or estate tax laws. If as a result of a waiver of the restrictions on the assessment and collection of a deficiency any part of the amount determined by the Board is paid after the filing of the review bond, such bond shall, at the request of the taxpayer, be proportionately reduced.

"(d) In cases where assessment or collection has not been stayed by the filing of a bond, then if the amount of the deficiency determined by the board is disallowed in whole or in part by the court, the amount so disallowed shall be credited or refunded to the taxpayer, without the making of claim therefor, or, if collection has not been made, shall be abated."

SEC. 604. SUITS TO RESTRAIN ENFORCEMENT OF LIABILITY OF TRANSFEREE OR FIDUCIARY.

No suit shall be maintained in any court for the purpose of restraining the assessment or collection of (1) the amount of the liability, at law or in equity, of a transferee of property of a taxpayer in respect of any income, war-profits, excess-profits, or estate tax, or (2) the amount of the liability of a fiduciary under section 3467 of the Revised Statutes in respect of any such tax.

SEC. 605. RETROACTIVE REGULATIONS.

Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect."

SEC. 606. CLOSING AGREEMENTS.

(a) Authorization.—The Commissioner (or any officer or employee of the Bureau of Internal Revenue, including the field service, authorized in writing by the Commissioner) is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal-revenue tax for any taxable period ending prior to the date of the agreement.

(b) Finality of agreements.—If such agreement is approved by the Secretary, or the Undersecretary, within such time as may be stated in such agreement, or later agreed to, such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact—

(1) the case shall not be reopened as to the matters agreed upon or the agreement modified, by any officer, employee, or agent of the United States, and

(2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled, modified, set aside, or disregarded.

(c) Section 1106 (b) of the Revenue Act of 1926 is repealed, effective on the expiration of 30 days after the enactment of this Act, but such repeal shall not affect any agreement made before such repeal takes effect.

ART. 1301. **Closing agreements relating to tax liability in respect of internal-revenue taxes.**—Closing agreements provided for in section 606 may relate to any taxable period ending prior to the date of the agreement. Such an agreement may be executed even though under such agreement the taxpayer is not liable for any tax for the period. The matter agreed upon may relate to the total tax liability of the taxpayer or it may relate to one or more separate items affecting the tax liability of the taxpayer. For example, an agreement may be entered into with respect to the amount of gross income, to deductions for losses, depreciation, depletion, etc., or to the value of property on a basic date. Accordingly, there may be a series of agreements relating to the tax liability for a single taxable period. Any tax or deficiency in tax determined pursuant to such an agreement shall be assessed and collected, and any overpayment determined pursuant thereto shall be credited or refunded, in accordance with the applicable provisions of the Act. (See also section 616.)

SEC. 607. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST UNITED STATES.

Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) after the expiration of the period of limitation properly

applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim.

SEC. 608. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST TAXPAYER.

A refund of any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) made after the enactment of this Act, shall be considered erroneous—

(a) if made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed; or

(b) in the case of a claim filed within the proper time and disallowed by the Commissioner after the enactment of this Act, if the refund was made after the expiration of the period of limitation for filing suit, unless—

(1) within such period suit was begun by the taxpayer, or

(2) within such period, the taxpayer and the Commissioner agreed in writing to suspend the running of the statute of limitations for filing suit from the date of the agreement to the date of final decision in one or more named cases then pending before the United States Board of Tax Appeals or the courts.

SEC. 609. ERRONEOUS CREDITS.

(a) Credit against barred deficiency.—Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607.

(b) Credit of barred overpayment.—A credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under section 608.

(c) Application of section.—The provisions of this section shall apply to any credit made before or after the enactment of this Act.

SEC. 610. RECOVERY OF AMOUNTS ERRONEOUSLY REFUNDED.

(a) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) refund of which is erroneously made, within the meaning of section 608, after the enactment of this Act, may be recovered by suit brought in the name of the United States, but only if such suit is begun within two years after the making of such refund.

(b) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded (if such refund would not be considered as erroneous under section 608) may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund or before May 1, 1928, whichever date is later.

SEC. 611. COLLECTIONS STAYED BY CLAIM IN ABATEMENT.

If any internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) was, within the period of limitation properly applicable thereto, assessed prior to June 2, 1924, and if a claim in abatement was filed, with or without bond, and if the collection of

any part thereof was stayed, then the payment of such part (made before or within one year after the enactment of this Act) shall not be considered as an overpayment under the provisions of section 607, relating to payments made after the expiration of the period of limitation on assessment and collection.

SEC. 612. REPEAL OF SECTION 1106 (a) OF 1926 ACT.

Section 1106 (a) of the Revenue Act of 1926 is repealed as of February 26, 1926.

SEC. 613. LIEN FOR TAXES.[1]

(a) Section 3186 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 3186. (a) If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person. Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

"(b) Such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

"(1) in accordance with the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law provided for the filing of such notice; or

"(2) in the office of the clerk of the United States District Court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law provided for the filing of such notice; or

"(3) in the office of the clerk of the Supreme Court of the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

"(c) Subject to such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, the collector of internal revenue charged with an assessment in respect of any tax—

"(1) May issue a certificate of release of the lien if the collector finds that the liability for the amount assessed, together with all interest in respect thereof, has been satisfied or has become unenforceable;

"(2) May issue a certificate of release of the lien if there is furnished to the collector and accepted by him a bond that is conditioned upon the payment of the amount assessed, together with all interest in respect thereof, within the time prescribed by law (including any extension of such time), and that is in accordance with such requirements relating to terms, conditions, and form of the bond and sureties thereon, as may be specified in the regulations;

[1] See T. D. 4275, p. 369.

"(3) May issue a certificate of partial discharge of any part of the property subject to the lien if the collector finds that the fair market value of that part of such property remaining subject to the lien is at least double the amount of the liability remaining unsatisfied in respect of such tax and the amount of all prior liens upon such property.

"(d) A certificate of release or of partial discharge issued under this section shall be held conclusive that the lien upon the property covered by the certificate is extinguished.

"(e) The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation provide for the acceptance of a single bond complying both with the requirements of section 272 (j) of the Revenue Act of 1928 (relating to the extension of time for the payment of a deficiency), or of any similar provisions of any prior law, and the requirements of subsection (c) of this section.

"(f) Subsections (c), (d), and (e) of this section shall apply to a lien in respect of any internal-revenue tax, whether or not the lien is imposed by this section."

(b) The second sentence of section 315 (a) of the Revenue Act of 1926 is repealed.

SEC. 614. INTEREST ON OVERPAYMENTS.

(a) Interest shall be allowed and paid upon any overpayment in respect of any internal-revenue tax, at the rate of 6 per centum per annum, as follows:

(1) In the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment of a tax imposed by the Revenue Act of 1921 or any subsequent revenue Act, then to the date of the assessment of that amount.

(2) In the case of a refund, from the date of the overpayment to a date preceding the date of the refund check by not more than 30 days, such date to be determined by the Commissioner.

(b) As used in this section the term "additional assessment" means a further assessment for a tax of the same character previously paid in part, and includes the assessment of a deficiency of any income or estate tax imposed by the Revenue Act of 1924 or by any subsequent revenue Act.

(c) Section 1116 of the Revenue Act of 1926 is repealed.

(d) Subsections (a), (b), and (c) shall take effect on the expiration of thirty days after the enactment of this Act, and shall be applicable to any credit taken or refund paid after the expiration of such period, even though allowed prior thereto.

SEC. 615. INTEREST ON JUDGMENTS.

(a) Section 177 of the Judicial Code, as amended, is amended to read as follows:

"SEC. 177. (a) No interest shall be allowed on any claim up to the time of the rendition of judgment by the Court of Claims, unless upon a contract expressly stipulating for the payment of interest, except as provided in subdivision (b).

"(b) In any judgment of any court rendered (whether against the United States, a collector or deputy collector of internal revenue, a former collector or deputy collector, or the personal representative in case of death) for any overpayment in respect of any internal-revenue tax, interest shall be allowed at the rate of 6 per centum per annum upon the amount of the overpayment, from the date of the payment or collection thereof to a date preceding the date of the refund check by not more than thirty days, such date to be determined by the Commissioner of Internal Revenue."

(b) Subsection (a) of this section shall take effect on the expiration of thirty days after the enactment of this Act.

SEC. 616. COMPROMISES—CONCEALMENT OF ASSETS.

Any person who, in connection with any compromise under section 3229 of the Revised Statutes, as amended, or offer of such compromise, or in connection with any closing agreement under section 606 of this Act, or offer to enter into any such agreement, willfully (1) conceals from any officer or employee of the United States any property belonging to the estate of a taxpayer or other person liable in respect of the tax, or (2) receives, destroys, mutilates, or falsifies any book, document, or record, or makes under oath any false statement, relating to the estate or financial condition of the taxpayer or other person liable in respect of the tax, shall, upon conviction thereof, be fined not more than $10,000 or imprisoned for not more than one year, or both.

SEC. 617. JURISDICTION OF COURTS.

(a) If any person is summoned under the internal-revenue laws to appear, to testify, or to produce books, papers, or other data, the district court of the United States for the district in which such person resides shall have jurisdiction by appropriate process to compel such attendance, testimony, or production of books, papers, or other data.

(b) The district courts of the United States at the instance of the United States are hereby invested with such jurisdiction to make and issue, both in actions at law and suits in equity, writs and orders of injunction, and of ne exeat republica, orders appointing receivers, and such other orders and process, and to render such judgments and decrees, granting in proper cases both legal and equitable relief together, as may be necessary or appropriate for the enforcement of the internal-revenue laws. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such laws.

SEC. 618. EXAMINATION OF BOOKS AND WITNESSES.

Section 1104 of the Revenue Act of 1926 is amended to read as follows:

"SEC. 1104. The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, by any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the matters required to be included in

the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons."

SEC. 619. MINOR ADMINISTRATIVE AMENDMENTS.

(a) Section 1109 of the Revenue Act of 1926 is amended by striking out "Except as provided in sections 277, 278, 310, and 311" and inserting in lieu thereof "Except in the case of income, war-profits, excess-profits, estate, and gift taxes."

(b) Section 3220 of the Revised Statutes, as amended by section 1111 of the Revenue Act of 1926, is amended by striking out "Except as otherwise provided in sections 284 and 319 of the Revenue Act of 1926" and inserting in lieu thereof "Except as otherwise provided by law in the case of income, war-profits, excess-profits, estate, and gift taxes."

(c) Section 3228 of the Revised Statutes, as amended by section 1112 of the Revenue Act of 1926, is amended by striking out "except as provided in sections 284 and 319 of the Revenue Act of 1926" and inserting "except as otherwise provided by law in the case of income, war-profits, excess-profits, estate, and gift taxes."

(d) Section 3176 of the Revised Statutes, as amended by section 1103 of the Revenue Act of 1926, is amended by striking out "other than a return under Title II of the Revenue Act of 1924 or Title II of the Revenue Act of 1926" and inserting in lieu thereof "other than a return of income tax."

TITLE V—GENERAL PROVISIONS

SEC. 701. DEFINITIONS.

(a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

(2) The term "corporation" includes associations, joint-stock companies, and insurance companies.

(3) The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State or Territory.

(4) The term "foreign" when applied to a corporation or partnership means a corporation or partnership which is not domestic.

(5) The term "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person.

(6) The term "withholding agent" means any person required to deduct and withhold any tax under the provisions of section 144 or 145.

(7) The term "stock" includes the share in an association, joint-stock company, or insurance company.

(8) The term "shareholder" includes a member in an association, joint-stock company, or insurance company.

(9) The term "United States" when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(10) The term "Secretary" means the Secretary of the Treasury.

(11) The term "Commissioner" means the Commissioner of Internal Revenue.

(12) The term "collector" means collector of internal revenue.

(13) The term "taxpayer" means any person subject to a tax imposed by this Act.

(14) The term "military or naval forces of the United States" includes the Marine Corps, the Coast Guard, the Army Nurse Corps, Female, and the Navy Nurse Corps, Female.

(b) The terms "includes" and "including" when used in a definition contained in this Act shall not be deemed to exclude other things otherwise within the meaning of the term defined.

ART. 1311. **Person.**—The Act recognizes four classes of persons—individuals, trusts and estates, partnerships, and corporations. Corporations include associations, joint-stock companies, and insurance companies, but not partnerships properly so called. A taxpayer is any person subject to a tax imposed by the Act.

ART. 1312. **Association.**—Associations and joint-stock companies include associations, common law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has invested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in quasi-corporate form is an association or corporation within the meaning of section 701.

ART. 1313. **Association distinguished from partnership.**—An organization, the membership interests in which are transferable and the business of which is conducted by trustees or directors and officers without the active participation of all the members as such, is an association and not a partnership. The term "partnership" means only ordinary partnerships. Organizations which have a fixed capital stock divided into shares represented by certificates transferable only upon the books of the company, which manage their affairs by a board of directors or executive officers, and which conduct their business in the general form and mode of corporations are joint-stock companies or associations within the meaning of the

Act even though under State law such organizations are technically partnerships.

ART. 1314. **Association distinguished from trust.**—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries, in the carrying on of any business, and the beneficiaries have no control over the trust, although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by sections 161–170 and by articles 861–891. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 701. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the Act.

ART. 1315. **Limited partnership as partnership.**—So-called limited partnerships of the type authorized by the statutes of New York and most of the States are partnerships and not corporations within the meaning of the Act. Such limited partnerships, which can not limit the liability of the general partners, although the special partners enjoy limited liability so long as they observe the statutory conditions, which are dissolved by the death or attempted transfer of the interest of a general partner, and which can not take real estate or sue in the partnership name, are so like common law partnerships as to render impracticable any differentiation in their treatment for tax purposes. Michigan and Illinois limited partnerships are partnerships. A California special partnership is a partnership.

ART. 1316. **Limited partnership as corporation.**—Limited partnerships of the type of partnerships with limited liability or partnership associations authorized by the statutes of Pennsylvania and of a few other States are only nominally partnerships. Such so-called limited partnerships, offering opportunity for limiting the liability of all the members, providing for the transferability of partnership shares, and capable of holding real estate and bringing suit in the partnership name, are more truly corporations than partnerships and must make returns of income and pay the tax as corporations. The income received by the members out of the earnings of such limited

partnerships will be treated in their personal returns in the same manner as distributions on the stock of corporations. In all doubtful cases limited partnerships will be treated as corporations unless they submit satisfactory proof that they are not in effect so organized. A Michigan partnership association is a corporation.

ART. 1317. **Joint ownership.**—Joint investment in and ownership of real and personal property not used in the operation of any trade or business and not covered by any partnership agreement does not constitute a partnership. Coowners of oil lands engaged in developing the property through a common agent are not necessarily partners.

ART. 1318. **Insurance company.**—Insurance companies include both stock and mutual companies, as well as mutual benefit insurance companies. A voluntary unincorporated association of employees formed for the purpose of relieving sick and aged members and the dependents of deceased members is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer. A corporation which merely sets aside a fund for the insurance of its employees is not required to file a separate return for such fund, but the income therefrom shall be included in the return of the corporation.

ART. 1319. **Domestic, foreign, resident, and nonresident persons.**—A domestic corporation or partnership is one organized or created in the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, or under the law of the United States or of any State or Territory. A partnership created by articles entered into in San Francisco between residents of the United States and residents of China is a domestic partnership. A foreign corporation or partnership is one which is not domestic. A domestic corporation is a resident corporation even though it does no business and owns no property in the United States. A foreign corporation engaged in trade or business within the United States or having an office or place of business therein is referred to in these regulations as a resident foreign corporation, and a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein, as a nonresident foreign corporation. A partnership engaged in trade or business within the United States or having an office or place of business therein is referred to in these regulations as a resident partnership, and a partnership not engaged in trade or business within the United States and not having any office or place of business therein, as a nonresident partnership. Whether a partnership is to be regarded as resident or nonresident is not determined by the

nationality or residence of its members or by the place in which it was created or organized.

ART. 1320. **Fiduciary.**—"Fiduciary" is a term which applies to persons that occupy positions of peculiar confidence toward others, such as trustees, executors, and administrators. A fiduciary for income tax purposes is a person who holds in trust an estate to which another has the beneficial title or in which another has a beneficial interest, or receives and controls income of another, as in the case of receivers. A committee or guardian of the property of an incompetent person is a fiduciary.

ART. 1321. **Fiduciary distinguished from agent.**—There may be a fiduciary relationship between an agent and a principal, but the word "agent" does not denote a fiduciary. A fiduciary relationship can not be created by a power of attorney. An agent having entire charge of property, with authority to effect and execute leases with tenants entirely on his own responsibility and without consulting his principal, merely turning over the net profits from the property periodically to his principal by virtue of authority conferred upon him by a power of attorney, is not a fiduciary within the meaning of the Act. In cases where no legal trust has been created in the estate controlled by the agent and attorney, the liability to make a return rests with the principal.

SEC. 702. BASIS OF PROPERTY UPON SALE BY ESTATE—RETROACTIVE.

(a) If in the return of any decedent's estate for any taxable year preceding the taxable year 1928, the basis, upon which gain or loss realized upon the sale or other disposition of property acquired by the estate from the decedent was computed, was the value of the property at the time of the death of the decedent or was in accordance with the regulations in force at the time such return was filed, then the computation of such gain or loss shall be made upon such basis, unless claim for refund or credit in respect of such basis, or a written election not to come within the provisions of this subsection, has been filed by the estate before the expiration of the period of limitation for filing claims.

(b) In every other case the computation of the gain or loss realized by an estate in any taxable year preceding the taxable year 1928 from the sale or other disposition by it of property acquired by the estate from the decedent, shall be made on such basis as is in accordance with the law properly applicable thereto, without regard to any provision of this Act.

SEC. 703. DEDUCTION OF ESTATE AND INHERITANCE TAXES—RETROACTIVE.

(a) In determining the net income of an heir, devisee, legatee, distributee, or beneficiary (hereinafter in this section referred to as

"beneficiary") or of an estate for any taxable year, under the Revenue Act of 1926 or any prior revenue Act, the amount of estate, inheritance, legacy, or succession taxes paid or accrued within such taxable year shall be allowed as a deduction as follows:

(1) If the deduction has been claimed by the estate, but not by the beneficiary, it shall be allowed to the estate;

(2) If the deduction has been claimed by the beneficiary, but not by the estate, it shall be allowed to the beneficiary;

(3) If the deduction has been claimed by the estate and also by the beneficiary, it shall be allowed to the estate (and not to the beneficiary) if the tax was actually paid by the legal representative of the estate to the taxing authorities of the jurisdiction imposing the tax; and it shall be allowed to the beneficiary (and not to the estate) if the tax was actually paid by the beneficiary to such taxing authorities;

(4) If the deduction has not been claimed by the estate nor by the beneficiary, it shall be allowed as a deduction only to the person (either the estate or the beneficiary) by whom the tax was paid to such taxing authorities, and only if a claim for refund or credit is filed within the period of limitation properly applicable thereto;

(5) Notwithstanding the provisions of paragraphs (1), (2), (3), and (4) of this subsection, if the claim of the deduction by the estate is barred by the statute of limitations, but such claim by the beneficiary is not so barred, the deduction shall be allowed to the beneficiary, and if such claim by the beneficiary is barred by the statute of limitations, but such claim by the estate is not so barred, the deduction shall be allowed to the estate.

(b) As used in this section, the term "claimed" means claimed—

(1) In the return; or

(2) In a claim in abatement filed in respect of an assessment made on or before June 2, 1924.

(c) This section shall not affect any case in which a decision of the Board of Tax Appeals or any court has been rendered prior to the enactment of this Act, whether or not such decision has become final.

SEC. 704. TAXABILITY OF TRUSTS AS CORPORATIONS—RETROACTIVE.

(a) If a taxpayer filed a return as a trust for any taxable year prior to the taxable year 1925 such taxpayer shall be taxable as a trust for such year and not as a corporation, if such taxpayer was considered to be taxable as a trust and not as a corporation either (1) under the regulations in force at the time the return was made or at the time of the termination of its existence, or (2) under any ruling of the Commissioner or any duly authorized officer of the Bureau of Internal Revenue applicable to any of such years, and interpretative of any provision of the Revenue Act of 1918, 1921, or 1924, which had not been reversed or revoked prior to the time the return was made, or under any such ruling made after the return was filed which had not been reversed or revoked prior to the time of the termination of the taxpayer's existence.

(b) For the purpose of the Revenue Act of 1926 and prior Revenue Acts, a trust shall, at the option of the trustee exercised within one year after the enactment of this Act, be considered as a trust the income of which is taxable (whether distributed or not) to the beneficiaries, and not as an association, if such trust (1) had a single trustee, and (2) was created and operated for the sole purpose of liquidating real property as a single venture (with such powers of administration as are incidental thereto, including the acquisition, improvement, conservation, division, and sale of such property), distributing the proceeds therefrom in due course to or for the benefit of the beneficiaries, and discharging indebtedness secured by the trust property, and (3) has not made a return for the taxable year as an association.

SEC. 705. INSTALLMENT SALES—RETROACTIVE.

(a) If any taxpayer by an original return made prior to February 26, 1926, changed the method of reporting his net income for the taxable year 1924 or any prior taxable year to the installment basis, then, if his income for such year is properly to be computed on the installment basis—

(1) No refund or credit of income, war-profits, or excess-profits taxes for the year in respect of which the change is made or any subsequent year shall be made or allowed, unless the taxpayer has overpaid his taxes for such year, computed by including, in computing income, amounts received during such year on account of sales or other dispositions of property made in any prior year; and

(2) No deficiency shall be determined or found in respect of any such taxes unless the taxpayer has underpaid his taxes for such year, computed by excluding, in computing income, amounts received during such year on account of sales or other dispositions of property made in any year prior to the year in respect of which the change was made.

(b) Nothing in this section shall be construed as in any manner modifying section 607, 608, 609, or 610 of this Act, relating to the effect of the running of the statute of limitations.

SEC. 706. CONTRIBUTIONS TO CHARITY—RETROACTIVE.

In computing the net income of any individual, other than a nonresident alien, for the taxable year 1923, there shall be allowed as a deduction (subject to the percentage limitation prescribed by section 214 (a) (11) of the Revenue Act of 1921) any contributions or gifts to or for the use of a trust organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, if such individual made during the taxable year 1924 contributions or gifts to the same trust and in the aggregate of substantially the same amount. In no case shall there be allowed as a deduction under this section contributions or gifts to an amount in excess of $50,000. Any tax paid in respect of such deduction shall, subject to the statutory period of limitation applicable thereto, be credited or refunded.

SEC. 707. INCOME TAX ON SALE OF VESSELS BUILT BEFORE 1914.

The second paragraph of section 23 of the Merchant Marine Act, 1920, is amended, to take effect as of June 5, 1920, to read as follows:

"During the period of ten years from June 5, 1920, any person, a citizen of the United States, who may sell a vessel documented under the laws of the United States and built prior to January 1, 1914, shall be exempt from all income taxes that would be payable upon any of the proceeds of such sale under the Revenue Act of 1918, or under any subsequent Revenue Act in force during such ten-year period, if the entire proceeds thereof shall be invested in the building of new ships in American shipyards, such ships to be documented under the laws of the United States and to be of a type approved by the board. The basis of any such new ship shall be reduced by the amount of the gain from such sale exempt from taxation under this paragraph."

SEC. 708. DEFINITION OF THE TERM "MOTOR BOAT."

The term "motor boat," when used in the Act of September 21, 1922, includes a yacht or pleasure boat, regardless of length or tonnage, whether sail, steam, or motor propelled, owned by a resident of the United States or brought into the United States for sale or charter to a resident thereof, whether or not such yacht or boat is brought into the United States under its own power, but does not include a yacht or boat used or intended to be used in trade or commerce, nor a yacht or boat built, or for the building of which a contract was entered into, prior to December 1, 1927.

SEC. 709. REMISSION OR MITIGATION OF FORFEITURES.

The provisions of law applicable to the remission or mitigation by the Secretary of the Treasury of forfeitures under the customs laws shall apply to forfeitures incurred or alleged to have been incurred, before or after the enactment of this Act, under the internal-revenue laws.

SEC. 710. REFUNDS AND CREDITS TO BE REFERRED TO JOINT COMMITTEE.

No refund or credit of any income, war-profits, excess-profits, estate or gift tax, in excess of $75,000, shall be made after the enactment of this Act, until after the expiration of thirty days from the date upon which a report giving the name of the person to whom the refund or credit is to be made, the amount of such refund or credit, and a summary of the facts and the decision of the Commissioner of Internal Revenue is submitted to the Joint Committee on Internal Revenue Taxation. A report to Congress shall be made annually by such committee of such refunds and credits, including the names of all persons and corporations to whom amounts are credited or payments are made, together with the amounts credited or paid to each.

SEC. 711. COMMISSIONERS OF COURT OF CLAIMS.

The salary of the commissioners of the Court of Claims provided for in the Act entitled "An Act to authorize the appointment of commis-

sioners by the Court of Claims and to prescribe their powers and compensation," approved February 24, 1925, as continued in force by Public Resolution 4, Seventieth Congress, approved January 11, 1928, shall after the date of the enactment of this Act be at the rate of $7,500 a year.

SEC. 712. BUREAU OF INTERNAL REVENUE—DETAILS TO WASHINGTON.

The Commissioner may order any officer or employee of the internal-revenue service engaged in field work to duty with the Bureau of Internal Revenue in the District of Columbia, for such periods as the Secretary may prescribe, and to any designated post of duty outside the District of Columbia, upon the completion of such duty.

SEC. 713. SALARIES OF COLLECTORS OF INTERNAL REVENUE.

Section 1301 (b) of the Revenue Act of 1918 is amended to read as follows:

"(b) The salaries of collectors may be readjusted and increased under such regulations as may be prescribed by the Commissioner, subject to the approval of the Secretary, but no collector shall receive a salary in excess of $7,500 a year."

SEC. 714. REPEALS.

The parts of the Revenue Act of 1926 which are repealed by this Act shall remain in force for the assessment and collection of all taxes imposed thereby, and for the assessment, imposition, and collection of all interest, penalties, or forfeitures which have accrued or may accrue in relation to any such taxes.

SEC. 715. SEPARABILITY CLAUSE.

If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act, and the application of such provision to other persons or circumstances, shall not be affected thereby.

SEC. 716. EFFECTIVE DATE OF ACT.

Except as otherwise provided, this Act shall take effect upon its enactment.

Approved, May 29, 1928, 8 a. m.

ART. 1501. **Promulgation of regulations.**—In pursuance of the Act the foregoing regulations are hereby made and promulgated.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 15, 1929.

A. W. MELLON,
Secretary of the Treasury.

TREASURY DECISIONS AMENDING OR RELATING TO REGULATIONS 74

(DECEMBER 1, 1931)

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TREASURY DECISIONS AMENDING OR RELATING TO REGULATIONS 74

(DECEMBER 1, 1931)

ART. 63. Improvements by lessees.

T. D. 4282 (approved December 19, 1929)

Article 63 of Regulations 74 is hereby amended to read as follows:

ART. 63. *Improvements by lessees.*—When buildings are erected or improvements made by a lessee in pursuance of an agreement with the lessor, and such buildings or improvements are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon either of the following bases:

(a) The lessor may report as income at the time when such buildings or improvements are completed the fair market value of such buildings or improvements subject to the lease.

(b) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the expiration of the lease and report as income for each year of the lease an aliquot part thereof.

Except in cases where the lessor has exercised the option to report income upon basis (b), if the lease is terminated so that the lessor comes into possession or control of the property prior to the time originally fixed for the expiration of the lease, the lessor derives no income by reason thereof, and, just as when the lessor comes into possession or control of the property upon the expiration of the lease, the basis for determining gain or loss to the lessor from the subsequent sale or other disposition of the buildings or improvements and for depreciation in respect of such property is the amount previously reported as income by the lessor because of the erection of the buildings or improvements, except that if the buildings or improvements were acquired prior to March 1, 1913, the basis shall be their value subject to the lease when acquired or their value subject to the lease on March 1, 1913, whichever is greater. If the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less any salvage value subject to the lease to the extent that such loss is not compensated for by insurance or otherwise. If the buildings or improvements destroyed were acquired prior to March 1, 1913, the deduction shall be based on their value subject to the lease when acquired or their

value subject to the lease on March 1, 1913, whichever is greater, less any salvage value subject to the lease to the extent that such loss is not compensated for by insurance or otherwise. (See articles 130 and 204.)

In all cases where the lessor has exercised the option to report income upon basis (b), if the lease is terminated so that the lessor comes into possession or control of the property prior to the time originally fixed for the expiration of the lease, the lessor derives additional income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he becomes entitled to such possession exceeds the amount already reported as income on account of the erection of such buildings or improvements. No appreciation in value due to causes other than the termination of the lease shall be included. If the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less any salvage value subject to the lease to the extent that such loss is not compensated for by insurance or otherwise.

ART. 87. Interest upon United States obligations.

T. D. 4276 (approved November 22, 1929)

Attention is invited to the Act entitled "An Act to amend section 5 of the Second Liberty Bond Act, as amended," approved June 17, 1929 (Public, No. 11, Seventy-first Congress, H. R. 1648), which, among other things, authorizes the Secretary of the Treasury to issue Treasury bills on a discount basis, payable at maturity without interest. That Act amends section 5 of the Second Liberty Bond Act, as amended, to read as follows, the tax provisions being contained in subdivision (b) thereof:

SEC. 5. (a) That in addition to the bonds and notes authorized by sections 1 and 18 of this Act, as amended, the Secretary of the Treasury is authorized to borrow from time to time, on the credit of the United States, for the purposes of this Act, to provide for the purchase or redemption before maturity of any certificates of indebtedness or Treasury bills issued hereunder, and to meet public expenditures authorized by law, such sum or sums as in his judgment may be necessary, and to issue therefor (1) certificates of indebtedness of the United States at not less than par and at such rate or rates of interest, payable at such time or times as he may prescribe; or (2) Treasury bills on a discount basis and payable at maturity without interest. Treasury bills to be issued hereunder shall be offered for sale on a competitive basis, under such regulations and upon such terms and conditions as the Secretary of the Treasury may prescribe, and the decisions of the Secretary in respect of any issue shall be final. Certificates of indebtedness and Treasury bills issued hereunder shall be in such form or forms and subject to such terms and conditions, shall be payable at such time, not exceeding one year from the date of issue, and may be redeemable before maturity upon such terms and conditions as the Secretary of the Treasury may prescribe. Treasury bills issued hereunder shall not be acceptable before maturity in payment of interest or of principal on account of obligations of foreign governments held by the United States of America. The sum of the par value of such certificates and Treasury bills outstanding hereunder and under section 6 of the First Liberty Bond Act shall not at any one time exceed in the aggregate $10,000,000,000.

(b) All certificates of indebtedness and Treasury bills issued hereunder (after the date upon which this subdivision becomes law) shall be exempt, both as to principal and interest, from all taxation (except estate and inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority; and the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest within the meaning of this subdivision.

(c) Wherever the words "bonds and notes of the United States," or "bonds and notes of the Government of the United States," or "bonds or notes of the United States" are used in the Federal Reserve Act, as amended, they shall be held to include certificates of indebtedness and Treasury bills issued hereunder.

The statement of the managers on the part of the House which accompanied the conference report (Report No. 17, Seventy-first Congress, first session) accompanying H. R. 1648 shows that Congress intended that the original discount rate at which a Treasury bill is issued should be regarded in the same way as the interest rate fixed by the security itself in the case of an interest-bearing obligation, and that the amount of the discount should be apportioned among the holders according to the periods of their holdings just as the interest on an interest-bearing obligation is apportioned. (See Sol. Op. 46, C. B. 3, p. 90.)

Accordingly, in the case of an original purchaser from the Government who holds a Treasury bill to maturity, the entire amount of the discount at which the bill was issued is exempt from income tax. If a bill is sold before maturity, each respective holder is entitled to treat as exempt from income tax that proportion of the amount of the discount at which the bill was issued which the number of days (computed on an actual calendar-day basis) the bill was owned by him bears to the total number of days (computed on an actual calendar-day basis) from the date of the issuance of the bill to the date of its maturity. In other words, the amount of the discount at which the bill was issued is to be apportioned among the holders according to the periods of their holdings. The gain from the sale or other disposition of a Treasury bill (that is, the excess of the amount realized therefrom less discount from the date of acquisition to the date of its disposition over the cost or other basis of the bill) is taxable as ordinary income. A loss from the sale or other disposition of a Treasury bill (that is, the excess of the cost or other basis of the bill over the amount realized therefrom less discount from the date of acquisition to the date of its disposition) is allowable as a deduction. There will be stated on each Treasury bill the amount of the discount at which it was issued.

The foregoing principles may be illustrated by the following examples:

Example 1: A 90-day Treasury bill is issued to A on March 17 for $9,900. The bill has a maturity value of $10,000 on the following June 15. A holds the bill to maturity. He may treat the entire amount of the discount, or $100, as tax-exempt interest.

Example 2: A Treasury bill is issued to A as in Example 1. A holds the bill until April 11 (25 days), on which date he sells it to B for $9,927.78. B holds the bill to maturity (i. e., for 65 days). A is entitled to treat 25/90ths of the amount of the discount, or $27.78, as tax-exempt interest, that amount being the proportion of the discount which the number of days A owned the bill (25) bears to the total number of days for which the bill was issued (90). Likewise, B is entitled to treat 65/90ths, or $72.22, as tax-exempt interest.

Example 3: A Treasury bill is issued to A as in example 1. A holds the bill until May 1, when he sells it to B for $9,962.50. B holds the bill to maturity. A is entitled to treat 45/90ths of the amount of the discount, or $50, as tax-exempt interest. A realizes a taxable gain of $12.50 in the transaction, computed as follows:

The amount A realizes from the sale is $9,962.50, which includes $50, representing discount to him. Therefore, $9,962.50 less $50, or $9,912.50, is the amount A realizes from the sale in addition to the discount treated as tax-exempt interest. Since the bill cost A $9,900. the amount of the gain is $9,912.50 less $9,900, or $12.50.

B is also entitled to treat 45/90ths of the amount of the discount, or $50, as tax-exempt interest. B sustains a deductible loss of $12.50 in the transaction, computed as follows:

The amount B realizes upon the maturity of the bill is $10,000, which includes $50, representing discount to him. Therefore, $10,000 less $50, or $9,950, is the amount B realizes upon the maturity of the bill in addition to the discount treated as tax-exempt interest. Since the bill cost B $9,962.50, the amount of his deductible loss is $9,962.50, less $9,950, or $12.50.

Example 4: A Treasury bill is issued to A as in example 1. A holds the bill until May 1, when he sells it to B for $9,937.50. B holds the bill to maturity. A is entitled to treat 45/90ths of the amount of the discount, or $50, as tax-exempt interest. A sustains a deductible loss of $12.50 in the transaction, computed as follows:

The amount A realizes from the sale is $9,937.50, which includes $50 representing discount to him. Therefore, $9,937.50 less $50, or $9,887.50, is the amount A realizes from the sale in addition to the discount treated as tax-exempt interest. Since the bill cost A $9,900, the amount of his deductible loss is $9,900 less $9,887.50, or $12.50.

B is also entitled to treat 45/90ths of the amount of the discount, or $50, as tax-exempt interest. B realizes a taxable gain of $12.50 in the transaction, computed as follows:

The amount B realizes upon the maturity of the bill is $10,000, which includes $50 representing discount to him. Therefore, $10,000 less $50, or $9,950, is the amount B realizes upon the maturity of the bill in addition to the discount treated as tax-exempt interest. Since the bill cost B $9,937.50, the amount of the gain is $9,950 less $9,937.50, or $12.50.

This Treasury decision is applicable only to the treatment of discount in the case of Treasury bills.

T. D. 4292 (approved June 25, 1930)

Attention is invited to the Act entitled "An Act providing certain exemptions from taxation for Treasury bills," approved June 17, 1930 (Public, No. 376, Seventy-first Congress, H. R. 12440 [C. B. IX–2, 458]), which amends section 5 of the Second Liberty Bond Act, as amended (Public, No. 11, Seventy-first Congress, June 17, 1929), by adding at the end thereof a new subdivision known as subdivisions (d). This new subdivision provides that any gain from the sale or other disposition of Treasury bills issued after the enactment of the Act approved June 17, 1930, shall be exempt from all Federal, State, and local taxation (except estate or inheritance taxes), and that no loss from the sale or other disposition of such Treasury bills shall be allowed as a deduction, or otherwise recognized, for the purposes of any tax imposed by the United States or any of its possessions. Section 5 of the Second Liberty Bond Act, as so amended, reads as follows, the tax-exemption provisions being contained in subdivisions (b) and (d) thereof:

> SEC. 5. (a) That in addition to the bonds and notes authorized by sections 1 and 18 of this Act, as amended, the Secretary of the Treasury is authorized to borrow from time to time, on the credit of the United States, for the purposes of this Act, to provide for the purchase or redemption before maturity of any certificates of indebtedness or Treasury bills issued hereunder, and to meet public expenditures authorized by law, such sum or sums as in his judgment may be necessary, and to issue therefor (1) certificates of indebtedness of the United States at not less than par and at such rate or rates of interest, payable at such time or times as he may prescribe; or (2) Treasury bills on a discount basis and payable at maturity without interest. Treasury bills to be issued hereunder shall be offered for sale on a competitive basis, under such regulations and upon such terms and conditions as the Secretary of the Treasury may prescribe, and the decisions of the Secretary in respect of any issue shall be final. Certificates of indebtedness and Treasury bills issued hereunder shall be

in such form or forms and subject to such terms and conditions, shall be payable at such time, not exceeding one year from the date of issue, and may be redeemable before maturity upon such terms and conditions as the Secretary of the Treasury may prescribe. Treasury bills issued hereunder shall not be acceptable before maturity in payment of interest or of principal on account of obligations of foreign governments held by the United States of America. The sum of the par value of such certificates and Treasury bills outstanding hereunder and under section 6 of the First Liberty Bond Act shall not at any one time exceed in the aggregate $10,000,000,000.

(b) All certificates of indebtedness and Treasury bills issued hereunder (after the date upon which this subdivision becomes law) shall be exempt, both as to principal and interest, from all taxation (except estate and inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority; and the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest within the meaning of this subdivision.

(c) Wherever the words "bonds and notes of the United States," or "bonds and notes of the Government of the United States," or "bonds or notes of the United States" are used in the Federal Reserve Act, as amended, they shall be held to include certificates of indebtedness and Treasury bills issued hereunder.

(d) Any gain from the sale or other disposition of Treasury bills issued hereunder (after the date upon which this subdivision becomes law) shall be exempt from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority; and no loss from the sale or other disposition of such Treasury bills shall be allowed as a deduction, or otherwise recognized, for the purposes of any tax now or hereafter imposed by the United States or any of its possessions.

The report of the Committee on Ways and Means (Report No. 1759, accompanying H. R. 12440) shows that it is the purpose of the Act approved June 17, 1930, to obviate the necessity, which existed under the law prior to its amendment by such Act, of keeping a complicated system of bookkeeping records in order to ascertain gain or loss from the sale or other disposition of Treasury bills as differentiated from the discount received on such bills.

Attention is also invited to section 22 (b) (4) of the Revenue Act of 1928, which provides in part as follows:

SEC. 22. (b) *Exclusions from gross income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title: * * * (4) * * * Interest upon (A) the obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia, or (B) securities issued under the provisions of the Federal Farm Loan Act, or under the provisions of such Act as amended; or (C) the obligations of the United States or its possessions. Every person owning any of the obligations or securities enumerated in clause (A), (B), or (C) shall, in the return required by this title, submit a statement showing the number and amount of such obligations and securities owned by him and the income received therefrom, in such form and with such information as the Commissioner may require. In the case of obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit), the interest shall be exempt only if and to the extent provided in the respective Acts authorizing the issue thereof as amended and supplemented, and shall be excluded from gross income only if and to the extent it is wholly exempt to the taxpayer from income taxes;

Article 81 of Regulations 74, promulgated under the Revenue Act of 1928, provides that "Every person owning obligations of a State, Territory, any political subdivision thereof, or the District of Columbia; securities issued under the provisions of the Federal Farm Loan Act or of such Act as amended; or obligations of the United States or its possessions, must, however, submit in his income tax return a statement showing the number and amount of such obligations and securities owned and the income received therefrom."

Under the above-quoted provisions of the Revenue Act of 1928 and Regulations 74, in the case of Treasury bills issued after June 17, 1930, (1) the "amount of such obligations and securities" is their par (maturity) value and (2) the "income received therefrom" is the net excess of the amount realized during the taxable year from the sale or other disposition of the bills over the cost or other basis thereof, no separate computation of discount being necessary. In such cases, and pending revision of the income tax forms, taxpayers making income tax returns shall submit the statement required by section 22 (b) (4) and article 81 in the form of a rider attached to the return.

ART. 251. Charges to capital and to expenses in the case of timber.

T. D. 4320 (approved August 6, 1931)

Article 251, Regulations 74, is hereby amended to read as follows:

ART. 251. *Charges to capital and to expenses in the case of timber.*—In the case of a timber property, all expenditures for administration, protection, and other carrying charges shall be charged to expense if paid or incurred, as the case may be, on or after August 6, 1931, regardless of whether the taxpayer has substantial income from the property or from other sources. Where the taxpayer has under applicable regulations charged to capital account carrying charges paid or incurred, as the case may be, prior to August 6, 1931, in respect of timber property held for future operation, such carrying charges will be regarded as items properly chargeable to capital account for the purpose of making proper adjustment to the cost or other basis of the property. (See article 561.) In the case of timber operations all expenditures for plants, improvements, and equipment shall be charged to capital account for purposes of depreciation.

ART. 271. **Payments to employees' pension trusts.**

T. D. 4310 (approved April 10, 1931)

The sixth paragraph of article 271 of Regulations 74 is hereby amended to read as follows:

> The right to a deduction under section 23(q) will be recognized in cases where the pension trust may not be perpetual, provided the trust is of such a character as to evidence good faith on the part of the employer actually to pay the amounts trusteed for employees' pension purposes. However, should any portion of the funds of a pension trust revert to the possession, ownership, or control of the employer by reason of the termination of the trust or otherwise, such amount (except to the extent that it represents a payment to the pension trust made by the employer in accordance with the pension plan and pursuant to paragraph (a) or (b) of this article, and not theretofore allowed as a deduction to the employer) shall be returned as income by the employer for the taxable year in which it so reverts, unless prior to the close of such year it shall be retrusteed for the benefit of employees under provisions satisfactory to the Commissioner.

ART. 421. **Inspection of returns.**

T. D. 4264 (approved March 14, 1929)

Treasury Decision 3856[1] [C. B. V–1, 106], as amended (being regulations prescribed by the Secretary and approved by the President and applicable to the inspection of returns under the Revenue Act of 1928 and prior revenue acts), is amended by adding at the end thereof the following new paragraph:

> 20. The Commissioner of Internal Revenue shall cause to be prepared a written decision in every case in which an overassessment (whether resulting in a refund, credit, or abatement) of an income, war-profits, excess-profits, estate, or gift tax is allowed, in excess of $20,000, and such decision shall be considered a public record and shall be open to inspection, during regular hours of business, in the office of the Commissioner of Internal Revenue or such office as he may designate. Such decision shall give the amount of the overassessment and shall be accompanied by a brief summary of the relevant facts and a citation of the authorities applicable thereto, or, in a case in which a decision of a court or of the Board of Tax Appeals has become final, by a citation of the court or board decision. Under no circumstances shall the provisions of this paragraph be construed as making any return, or any part thereof, open to inspection, or as authorizing the source of any income, gains, or profits, or the specific transactions resulting in losses or expenditures, to be made public; nor shall any of the information contained in any return or relating thereto be made public except in accordance with, and to the extent necessary in carrying out, these regulations.

T. D. 4291 (approved April 8, 1930)

Paragraph 13 of Treasury Decision 3856 (being regulations prescribed by the Secretary and approved by the President, as amended,

[1] Treasury Decision 3856 as amended was incorporated and made a part of article 421.

applicable to the inspection of returns under the Revenue Act of 1928 and prior revenue acts), is amended by adding at the end thereof the following new sentence:

> The Secretary of the Treasury, upon such conditions and limitations as he may impose, is authorized to permit the inspection of returns, upon the written request of the Secretary of Commerce, by such officers and employees as the Secretary of Commerce may designate, for statistical purposes.

T. D. 4317 (approved June 9, 1931)

Treasury Decision 3856 (C. B. V–1, 106), as amended by Treasury Decisions 4187 (C. B. VII–2, 161), 4264 (C. B. VIII–1, 93), and 4291 (C. B. IX–1, 127) (being regulations prescribed by the Secretary of the Treasury and approved by the President, applicable to the inspection of returns under the Revenue Act of 1928 and prior revenue acts), is further amended by changing paragraphs 3, 5, 6, 7, 8, and 9 thereof to read as follows:

> 3. Information returns and other written statements filed with the Commissioner of Internal Revenue designed to be supplemental to or to become a part of tax returns shall be subject to the same rules and regulations as to inspection as are the tax returns themselves.
>
> 5. The return of an individual shall be open to inspection (a) by the person who made the return, or by his duly constituted attorney in fact; (b) if the maker of the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; (c) in the discretion of the Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of such deceased person, upon a showing that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law, next of kin, or beneficiary; and (d) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection, by an officer of any State having a law imposing an income tax upon the individual, upon written application signed by the governor of such State under the seal of the State, designating the officer to make the inspection and showing that the inspection is solely for State income tax purposes.
>
> 6. A joint return of a husband and wife shall be open to inspection (a) by either spouse for whom the return was made, upon satisfactory evidence of such relationship being furnished, or by his or her duly constituted attorney in fact; (b) if either spouse has died, by the administrator, executor, or trustee of his or her estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; (c) in the discretion of the Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of such deceased spouse, upon a showing that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir

at law, next of kin, or beneficiary; and (d) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection, by an officer of any State having a law imposing an income tax upon either spouse, upon written application signed by the governor of such State under the seal of the State, designating the officer to make the inspection and showing that the inspection is solely for State income tax purposes.

7. The return of a partnership shall be open to inspection (a) by any individual who was a member of such partnership during any part of the time covered by the return upon satisfactory evidence of such fact being furnished, or by his duly constituted attorney in fact; (b) if a member of such partnership during any part of the time covered by the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; (c) in the discretion of the Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of such deceased person, upon a showing that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law, next of kin, or beneficiary; and (d) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection, by an officer of any State having a law imposing an income tax upon the partnership or upon any member thereof in respect of income therefrom, upon written application signed by the governor of such State under the seal of the State, designating the officer to make the inspection and showing that the inspection is solely for State income tax purposes.

8. The return of an estate shall be open to inspection (a) by the administrator, executor, or trustee of such estate, or by his duly constituted attorney in fact; (b) in the discretion of the Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of the deceased person for whose estate the return is made, upon a showing of material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law, next of kin, or beneficiary; and (c) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection, by an officer of any State having a law imposing an income tax upon the estate or upon any beneficiary of the estate in respect of income therefrom, upon written application signed by the governor of such State under the seal of the State, designating the officer to make the inspection and showing that the inspection is solely for State income tax purposes.

9. The return of a trust shall be open to inspection (a) by the trustee or trustees, jointly or severally, or the duly constituted attorney in fact of such trustee or trustees; (b) by any individual who was a beneficiary of such trust during any part of the time covered by the return, upon satisfactory evidence of such fact being furnished, or by his duly constituted attorney in fact; (c) if any individual who was a beneficiary of such trust during any part of the time covered by the return has died, by the administrator, executor, or trustee of his estate, or by the duly constituted attorney in fact of such administrator, executor, or trustee; (d) in the discretion of the

Commissioner of Internal Revenue, by any heir at law, next of kin, or beneficiary under the will, of such deceased person, upon a showing that such heir at law, next of kin, or beneficiary has a material interest which will be affected by information contained in the return, or by the duly constituted attorney in fact of such heir at law, next of kin, or beneficiary; and (e) in the discretion of the Commissioner of Internal Revenue, and at such time and in such manner as the Commissioner may prescribe for the inspection, by an officer of any State having a law imposing an income tax upon the trust or upon any beneficiary of the trust in respect of income therefrom, upon written application signed by the governor of such State under the seal of the State, designating the officer to make the inspection and showing that the inspection is solely for State income tax purposes.

ART. 451. Examination of return and determination of tax by the Commissioner.

T. D. 4327 (approved October 5, 1931)

It has been decided that the matters of procedure prescribed in article 451 of Regulations 74 relative to the examination of income tax returns and the determination of the correct amount of the tax by the Commissioner, such matters being subject to change from time to time, may be more appropriately prescribed in mimeographs signed by the Commissioner of Internal Revenue and published in the Internal Revenue Bulletin service than in the Income Tax Regulations. The subject matter of article 451 will, therefore, be revised and published as a mimeograph. This necessitates the amendment of article 451 of Regulations 74. Accordingly, that article is hereby amended to read as follows:

ART. 451. *Examination of return and determination of tax by the Commissioner.*—As soon as practicable after returns are filed, they will be examined and the correct amount of the tax determined under such procedure as may be prescribed from time to time by the Commissioner. (See sections 57 and 272 and article 1171.)

ART. 501. Definition and illustration of capital net gain.

T. D. 4312 (approved April 10, 1931)

Article 501, Regulations 74, is hereby amended by the elimination of the next to the last paragraph thereof and the substitution therefor of a paragraph reading as follows:

Since the credit allowed an individual by section 31 in respect of earned income shall not exceed 25 per cent of his normal tax plus 25 per cent of the surtax which would be payable if his earned income constituted his entire net income, no credit under section 31 may be claimed by a taxpayer whose entire gross income consists of capital gain and who elects to be taxed under section 101.

ART. 561. Determination of the amount of gain or loss.

T. D. 4321 (approved August 6, 1931)

Article 561, Regulations 74, is hereby amended by the elimination of the third and fourth sentences of the second paragraph thereof, and the substitution therefor of two sentences reading as follows:

In computing the amount of gain or loss, however, the cost or other basis of the property shall be properly adjusted for any expenditure, receipt, loss, or other item properly chargeable to capital account, including the cost of improvements and betterments made to the property since the basic date. Carrying charges, such as interest and taxes on unproductive property, may not be treated as items properly chargeable to capital account, except in the case of carrying charges paid or incurred, as the case may be, prior to August 6, 1931, by a taxpayer who did not elect to deduct carrying charges in computing net income and did not use such charges in determining his liability for filing returns of income.

ART. 600. Stock or securities distributed in reorganization.

T. D. 4274 (approved November 13, 1929)

* * * * * * *

Article 600 of Regulations 74 is hereby amended to read as follows:

ART. 600. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112 (g) and article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old shares and the new shares or securities shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization consists solely of stock in the distributing corporation and is all of substantially the same character and preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part stock in a corporation a party to the reorganization other than the distributing corporation, or where the stock distributed in reorganization is in whole or in part stock of a character or preference materially different from the stock in respect of which the distribution is made, or where the distribution consists wholly or partly of securities other than stock, the cost or other basis of the stock in respect of which the distribution is made shall be apportioned between such stock and the stock or securities distributed in proportion, as nearly as may be, to the respective values of each class of stock or security, old and new, at the time of such distribution, and the basis of each share of stock or unit of security will be the quotient of the cost or other basis of the class of stock or security with which such share or unit belongs, divided by the number of shares or units in the class. Within the meaning of the foregoing provision, securities are different in class from stocks, stocks or securities in one corporation are different in class from stocks or securities in another corporation, and, in general, any material difference in character or preference or terms sufficient to distinguish one stock or security from another stock or security so that different values may properly be assigned thereto, will constitute a difference in class.

(3) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the identity of the lots can not be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see article 58), and any sale of the stock or securities distributed in reorganization will be presumed to have been made from the stock or securities distributed in respect of the earliest purchased stock.

(4) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the stock or securities distributed in reorganization can not be identified as having been distributed in respect of any particular lot of such stock, then any sale of the stock or securities distributed in reorganization will be presumed to have been made from the stock or securities distributed in respect of the earliest purchased stock.

SEC. 116. (e) BRIDGES TO BE ACQUIRED BY STATE OR POLITICAL SUBDIVISION.

T. D. 4303 (approved January 7, 1931)

Section 116 (e) of the Revenue Act of 1928 provides as follows:

(e) *Bridges to be acquired by State or political subdivision.*—Whenever any State or political subdivision thereof, in pursuance of a contract to which it is not a party entered into before the enactment of this Act, is to acquire a bridge—

(1) If by the terms of such contract the tax imposed by this title is to be paid out of the proceeds from the operation of such bridge prior to any division of such proceeds, and if, but for the imposition of the tax imposed by this title, a part of such proceeds for the taxable year would accrue directly to or for the use of or would be applied for the benefit of such State or political subdivision, then a tax upon the net income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title, but there shall be refunded to such State or political subdivision (under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary) an amount which bears the same relation to the amount of the tax as the amount which (but for the imposition of the tax imposed by this title) would have accrued directly to or for the use of or would be applied for the benefit of such State or political subdivision, bears to the amount of the net income from the operation of such bridge for such taxable year. No such refund shall be made unless the entire amount of the refund is to be applied in part payment for the acquisition of such bridge.

(2) If by the terms of such contract no part of the proceeds from the operation of the bridge for the taxable year would, irrespective of the tax imposed by this title, accrue directly to or for the use of or be applied for the benefit of such State or political subdivision, then the tax upon the net income from the operation of such bridge shall be levied, assessed, collected, and paid in the manner and at the rates prescribed in this title.

Pursuant to authority contained in section 116 (e) quoted above, the following rules and regulations relative to the filing, allowance, and payment of claims for refund under that section are hereby established for the guidance of taxpayers and States or political subdivisions thereof concerned:

(1) Any State or political subdivision thereof claiming a refund under the provisions of section 116 (e) of the Revenue Act of 1928 of an amount equal to all or a portion of any income tax levied, assessed, collected, and paid in the manner and at the rates prescribed in Title I of that Act, shall file a claim therefor on Form 843 (to which there shall be attached as exhibits the matter hereinafter prescribed) with the collector of internal revenue for the district in which the tax was paid, which claim shall be executed on behalf of such State or political subdivision thereof by the treasurer or other fiscal officer thereof and shall contain—

(a) A statement of the name of the taxpayer, of the amount of tax levied, assessed, collected, and paid for the taxable year or period in respect of which the claim is made, and the amount of refund thereby sought,

(b) A full statement of the facts considered by the claimant sufficient to entitle it to receive the refund, including copies of all contracts and/or other documents bearing on the case, and a statement that the claim is submitted under the provisions of section 116 (e) of the Revenue Act of 1928,

(c) A showing which will establish to the satisfaction of the Commissioner that the fiscal officer presenting the claim has authority to receive the amount of the refund on behalf of the State or political subdivision which he assumes to represent and to apply without delay the entire amount of such refund in part payment for the acquisition of such bridge, including copies of the laws, ordinances, or similar enactments considered by the claimant sufficient to establish its authority to receive the refund and so to apply it, together with a statement that such fiscal officer will receive and immediately so apply the entire amount of the refund,

(d) An affidavit made by or on behalf of the taxpayer, which affidavit shall state that the taxpayer thereby joins with and concurs in the request of the State or political subdivision thereof that a refund of an amount equal to all or a portion of the tax previously paid by such taxpayer be made to such State or political subdivision, that the taxpayer agrees to receive the amount refunded from the State or political subdivision to which it is paid and immediately to apply the entire amount of such refund in part payment for the acquisition of such bridge, and that if for any reason the contract which is the basis of the claim for refund is not fully executed and performed, the taxpayer will repay to the United States upon its demand the entire amount of the refund with interest at 6 per cent per annum from the date the refund is made without seeking or claiming the benefit of any statute of limitations which prior thereto may have run against the United States.

(2) No refund shall be made of any amount in excess of the amount of the tax levied, assessed, collected, and paid by the taxpayer for any taxable year or period. A separate claim shall be made in respect of each separate taxable year or period. If by the terms of the contract on which the claim is based two or more States or political subdivisions of a State or States are entitled to acquire the bridge, the claim for refund in respect of each separate taxable year or period must be made jointly by the States or political subdivisions thereof so entitled. The amount refunded under section 116 (e) of the Revenue Act of 1928 and this Treasury decision is not considered an overpayment within the meaning of section 614 of the Revenue Act of 1928, relating to interest on overpayments, and no interest shall be allowed or paid upon the amount of the refund.

(3) A check or voucher in payment of a claim for refund allowed under section 116 (e) of the Revenue Act of 1928 will be drawn in the name of the fiscal officer or officers having authority, as established under paragraph (1) (c) hereof, to receive the same, and will contain an express provision that it is issued for the sole purpose and subject to the conditions prescribed in section 116 (e) of the Revenue Act of 1928 and this Treasury decision.

ART. 698. Domestic corporation owning a majority of the stock of foreign corporation.

T. D. 4323 (approved September 28, 1931)

Article 698 of Regulations 74 is hereby amended to read as follows:

ART. 698. *Domestic corporation owning a majority of the stock of foreign corporation.*—In the case of a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 23 (p)) in any taxable year, the credit for foreign taxes includes not only the income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States by such domestic corporation, but also a credit for income, war-profits, and excess-profits taxes deemed to have been paid determined by taking the same proportion of any income, war-profits, and excess-profits taxes paid or accrued by such controlled foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. The credit for taxes deemed to have been paid is limited, however, to an amount which shall in no case exceed the same proportion of the taxes against which the credit for foreign taxes is taken, which the amount of such dividends bears to the amount of the entire net income of the domestic corporation in which such dividends are included. If dividends are received from more than one controlled foreign corporation, the limitation is to be computed separately for the dividends received from each controlled foreign corporation. The credit for foreign taxes (including taxes paid or accrued by the domestic corporation and the credit for taxes deemed to have been paid) may not, under any circumstances, exceed the same proportion of the tax (computed on the basis of the domestic corporation's net income without the deduction of any income, war-profits, or excess-profits tax any part of which may be allowed to the corporation as a credit by section 131), against which the credit is taken, which the domestic corporation's net income (computed without the deduction of any such income, war-profits, and excess-profits tax) from sources without the United States bears to its entire net income (computed without such deduction) for the same taxable year. A domestic corporation which includes in the credit for foreign taxes a credit for taxes deemed to have

been paid must furnish the same information with respect to the taxes deemed to have been paid as it is required to furnish with respect to the taxes actually paid or accrued by it.

Taxes paid or accrued by a controlled foreign corporation are deemed to have been paid by the domestic corporation for purposes of credit only. Where the credit for foreign taxes includes both taxes paid or accrued by a domestic corporation and a credit for taxes deemed to have been paid, and the sum of the taxes paid or accrued and the credit for taxes deemed to have been paid exceeds the limitation on the entire amount of the credit allowable, the excess shall be apportioned between the taxes paid or accrued and the credit for taxes deemed to have been paid in proportion to their respective amounts. The portion of the excess apportioned to the taxes paid or accrued, but not that apportioned to the credit for taxes deemed to have been paid, shall be allowed as a deduction from gross income under the provisions of section 23 (c).

ART. 811. Return of information as to payments of $1,500.

T. D. 4302 (approved December 2, 1930)

The first sentence of article 811, Regulations 74, as amended by Treasury Decision 4278 (C. B. VIII–2, 138), is hereby further amended to read as follows:

All persons making payment to another person of fixed or determinable income of $1,500 or more in any calendar year must render a return thereof to the Commissioner for such year on or before February 15 of the following year except as specified in articles 813–815.

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ART. 812. Return of information as to payments to employees.

T. D. 4302 (approved December 2, 1930)

* * * * * * *

The second sentence of article 812 of Regulations 74, as amended by Treasury Decision 4278, is hereby further amended to read as follows:

Heads of branch offices and subcontractors employing labor, who keep the only complete record of payments therefor, should file returns of information in regard to such payments directly with the Commissioner.

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ART. 817. Return of information as to foreign items.

T. D. 4302 (approved December 2, 1930)

* * * * * * *

The last sentence of article 817, Regulations 74, as amended by Treasury Decision 4278, is hereby further amended to read as follows:

Such forms accompanied by Form 1096 should be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., on or before February 15 of each year.

ART. 831. Return of information as to payments of dividends.

T. D. 4277 (approved November 23, 1929)

Section 149 of the Revenue Act of 1928 provides that every corporation subject to income tax shall, when required by the Commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each shareholder, the number of shares owned by him, and the amount of dividends paid to him. In accordance with this section of the Act, returns of information in respect of dividend payments shall be rendered for the calendar year 1929 and each calendar year thereafter as follows:

(a) Except as provided in paragraph (b) below, every domestic or resident foreign corporation and every nonresident foreign corporation having a fiscal or paying agent in the United States, not specifically exempt from taxation, making payments of dividends and distributions out of its earnings or profits accumulated since February 28, 1913 (other than stock dividends or distributions in liquidation), to any shareholder who is an individual (citizen, resident, or nonresident alien), a fiduciary, or a partnership, amounting to $500 or more during the calendar year, shall render an information return on Forms 1096 and 1099 for the calendar year 1929 and each calendar year thereafter. A separate Form 1099 must be prepared for each shareholder, upon which will be shown the name and address of the shareholder to whom such payment was made, and the amount paid. These forms, accompanied by letter of transmittal on Form 1096 showing the number of Forms 1099 filed therewith, shall be forwarded to the collector of internal revenue for the district in which the corporation has its principal office or place of business on or before February 15 of the following year.[1]

(b) In cases where distributions are made from a depletion or depreciation reserve, or which for any other reason are deemed by the corporation to be nontaxable or partly nontaxable to its shareholders, the corporation will first fill in the information on the reverse side of Form 1096 and forward this form to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., not later than February 1 of the following year. Upon receipt of this information the Commissioner will determine and advise the corporation by letter whether any portion of such distribution is subject to tax. The corporation after receiving this letter will then properly prepare for each shareholder a Form 1099, which shall be forwarded with Form 1096 to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., not later than 30 days after such letter is received.

[1] See T. D. 4305, p. 364.

In any case where it is impossible to file the return within the time herein prescribed, the corporation may, upon a showing of such fact, obtain a reasonable extension of time for filing the return. The request for the extension of time must be forwarded to the collector on or before the date prescribed for filing the return.[1]

Treasury Decision 4236 (C. B. VII-2, p. 71), in so far as it is inconsistent with the provisions of this Treasury decision, is hereby revoked.

ART. 831. Return of information as to payments of dividends.

T. D. 4305 (approved January 19, 1931)

The last sentence of the second paragraph of Treasury Decision 4277 (C. B. VIII-2, 140) is hereby amended to read as follows:

> These forms, accompanied by letter of transmittal on Form 1096 showing the number of Forms 1099 filed therewith, shall be forwarded to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., on or before February 15 of the following year.

The last sentence of the fourth paragraph of Treasury Decision 4277 is hereby amended to read as follows:

> The request for the extension of time must be forwarded to the Commissioner of Internal Revenue, Rules and Regulations Section, Washington, D. C., on or before the date prescribed for filing the return.

ART. 996. Net losses; insurance companies.

T. D. 4309 (approved March 7, 1931)

Regulations 74 are hereby amended by the addition thereto of the following new matter dealing with net losses of insurance companies:

> ART. 996. *Net losses; insurance companies.*—In the case of an insurance company subject to the tax imposed by section 201, the "net loss" is the amount by which gross income as defined in section 202 (a) is exceeded by the deductions allowed by section 203 excluding:
>
> (*a*) The amount of interest received during the taxable year allowed as a deduction under section 203 (a) (1), in excess of the amount of interest paid within the taxable year which is not deductible under section 203 (a) (8);
>
> (*b*) The amount received as dividends and allowed as a deduction under section 203 (a) (3);
>
> (*c*) The amount allowed as a deduction under section 203 (a) (4) on account of sums held as a reserve for dividends; and
>
> (*d*) The amount allowed as a specific credit under section 203 (a) (9).
>
> In the case of an insurance company subject to the tax imposed by section 204, the "net loss" is the amount by which gross income as defined in section 204 (b) (1) is exceeded by the deductions allowed by section 204 (c) excluding:
>
> (*a*) The amount of interest earned during the taxable year allowed as a deduction under that part of section 204 (c) (8) which refers to interest exempt from taxation under section 22 (b) (4), in excess of the amount of interest accrued within the taxable year which is not deductible under section 204 (c) (2) in view of the provisions of section 23 (b);
>
> (*b*) The amount of interest allowed as a deduction under that part of section 204 (c) (8) which refers to interest allowed as a credit under section 26;
>
> (*c*) The amount received as dividends and allowed as a deduction under section 204 (c) (7); and
>
> (*d*) The amount allowed as a specific credit under section 204 (c) (10).

[1] See T. D. 4305, this page.

ART. 1042. Exclusion of earnings of foreign ships from gross income.

T. D. 4269 (approved June 29, 1929)

Section 213 (b) (8) of the Revenue Acts of 1921, 1924, and 1926, and sections 212 (b) and 231 (b) of the Revenue Acts of 1928, provide that there shall be exempt from taxation the income of a nonresident alien or foreign corporation which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

Greece grants an equivalent exemption to citizens of the United States and to corporations organized in the United States, from January 1, 1921. Accordingly, article 89 of Regulations 62, as amended by Treasury Decisions 3488 (C. B. II-1, p. 80), 3813 (C. B. V-1, p. 225), 4013 (C. B. VI-1, p. 59), 4098 (C. B. VI-2, p. 58), and 4227 (Bulletin VII-42, p. 4 [C. B. VII-2, 125]); article 89 of Regulations 65, as amended by Treasury Decisions 3812 (C. B. V-1, p. 47), 4013 (C. B. VI-1, p. 59), 4098 (C. B. VI-2, p. 58), and 4227 (Bulletin VII-42, p. 4 [C. B. VII-2, 125]); article 89 of Regulations 69, as amended by Treasury Decisions 4013 (C. B. VI-1, p. 59), 4098 (C. B. VI-2, p. 58), and 4227 (Bulletin VII-42, p. 4 [C. B. VII-2, 125]); and article 1042 of Regulations 74 are hereby amended so as to include Greece in the list of countries which exempt from tax so much of the income of citizens of the United States nonresident in such foreign countries and of corporations organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States, and to exclude Greece from the list of countries which do not grant such exemption.

T. D. 4289 (approved April 25, 1930)

Section 213 (b) (8) of the Revenue Acts of 1921, 1924, and 1926, and sections 212 (b) and 231 (b) of the Revenue Act of 1928, provide that there shall be exempt from taxation the income of a nonresident alien or foreign corporation which consists exclusively of earnings derived from the operation of a ship or ships documented

under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

Spain grants an equivalent exemption to citizens of the United States and corporations organized in the United States, from January 1, 1921. Accordingly, article 89 of Regulations 62, as amended by Treasury Decisions 3488 (C. B. II–1, p. 80), 3813 (C. B. V–1, p. 225), 4013 (C. B. VI–1, p. 59), 4098 (C. B. VI–2, p. 58), 4135 (C. B. VII–1, p. 81), 4227 (C. B. VII–2, p. 125), and 4269 (Bulletin VIII–27, p. 5 [C. B. VIII–2, p. 146]); article 89 of Regulations 65, as amended by Treasury Decisions 3812 (C. B. V–1, p. 47), 4013 (C. B. VI–1, p. 59), 4098 (C. B. VI–2, p. 58), 4135 (C. B. VII–1, p. 81), 4227 (C. B. VII–2, p. 125), and 4269 (Bulletin VIII–27, p. 5 [C. B. VIII–2, p. 146]); article 89 of Regulations 69, as amended by Treasury Decisions 4013 (C. B. VI–1, p. 59), 4098 (C. B. VI–2, p. 58), 4135 (C. B. VII–1, p. 81), 4227 (C. B. VII–2, p. 125), and 4269 (Bulletin VIII–27, p. 5 [C. B. VIII–2, p. 146]); and article 1042 of Regulations 74, as amended by Treasury Decision 4269 (Bulletin VIII–27, p. 5 [C. B. VIII–2, p. 146]), are hereby further amended so as to include Spain in the list of countries which exempt from tax so much of the income of citizens of the United States nonresident in such foreign countries and of corporations organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States, and to exclude Spain from the list of countries which do not grant such exemption.

T. D. 4299 (approved September 10, 1930)

Sections 212 (b) and 231 (b) of the Revenue Act of 1928 provide that there shall be exempt from taxation the income of a nonresident alien or foreign corporation which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

Brazil grants an equivalent exemption to citizens of the United States and corporations organized in the United States. Accordingly, article 1042 of Regulations 74, as amended by Treasury Decisions 4269 (C. B. VIII–2, p. 146) and 4289 (C. B. IX–1, p. 160), is hereby further amended so as to include Brazil (from December 30, 1928, only, when the Brazilian law, designated as Decree No. 5623, went into effect) in the list of countries which exempt from taxation so much of the income of citizens of the United States nonresident in such foreign countries and of corporations organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States, and to exclude Brazil (from December 30, 1928) from the list of countries which do not grant such exemption.

ART. 1173. **Extension of time for payment of a deficiency.**

T. D. 4315 (approved May 26, 1931)

The second paragraphs of article 1234 of Regulations 69 and article 1173 of Regulations 74 are hereby amended by adding at the end of each paragraph a new sentence reading as follows:

> The Commissioner will not consider an application for an extension of time for the payment of a deficiency unless such application is made on or before the date prescribed for payment thereof, as shown by the notice and demand from the collector.

As so amended, the said paragraphs read as follows:

> An application for an extension of time for the payment of a deficiency should be made under oath on Form 1127 and must be accompanied by evidence showing that undue hardship to the taxpayer would result if the extension were refused. The extension will not be granted on a general statement of hardship, but in each case there must be furnished a statement of the specific facts showing what, if any, financial loss or sacrifice will result if the extension is not granted. Wherever practicable a certified statement of assets and liabilities of the taxpayer should be submitted. The application, with the evidence, must be filed with the collector, who will at once transmit it to the Commissioner with his recommendations as to the extension. When it is received by the Commissioner, it will be examined immediately and, if possible, within 30 days will be rejected, approved, or tentatively approved subject to certain conditions of which the taxpayer will be immediately notified. The Commissioner will not consider an application for an extension of time for the payment of a deficiency unless such application is made on or before the date prescribed for payment thereof, as shown by the notice and demand from the collector.

ART. 1254. **Claims for refund by taxpayers.**

T. D. 4265 (approved March 27, 1929)

(1) A claim for refund or credit of any internal revenue tax, or for refund of interest or penalties, erroneously or illegally collected should be made on the form prescribed by the Treasury Department (Form 843), and should be filed with the collector of internal revenue, although a claim will not be considered defective solely by reason of the fact that it is not made on the form or that it is filed with the Commissioner of Internal Revenue. The claim must set forth in detail and under oath each ground upon which a refund or credit is claimed, and facts sufficient to apprise the Commissioner of the exact basis thereof. Any claim which does not comply with the

requirements of the preceding sentence will not be considered for any purpose as a claim for refund or credit.

(2) No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds so set forth in a claim, or an amendment thereof, filed prior to the expiration of such period.

(3) These regulations shall take effect on May 1, 1929, and shall be applicable to all claims filed on or after such date, and all other regulations are modified in so far as they are inconsistent with these regulations.

T. D. 4266 (approved March 27, 1929)

(1) Except as provided in paragraph (2), a refund or credit of any internal revenue tax will not be allowed in any case after the expiration of the statutory period of limitation applicable to the filing of a claim therefor (computed without regard to the filing of any so-called informal or defective claim) unless prior to the expiration of such period a formal claim has been duly filed which complies with all the requirements of the regulations applicable at the time such claim was filed, nor will any claim which does not comply with such regulations be considered for any purpose as a claim for refund or credit. (See e. g. Reg. 14; art. 1036, Reg. 45 and 62; art. 1306, Reg. 65; art. 1304, Reg. 69; art. 1254, Reg. 74; Law Opinion 1116 [C. B. III–1, 350]; T. D. 4265 [C. B. VIII–1, 110].)

(2) A refund or credit may be allowed after the expiration of such statutory period of limitation, even if no formal claim has been filed prior thereto, in any case in which a so-called informal or defective claim, duly filed prior to the expiration of such period and stating specifically the grounds for the refund or credit, is perfected by the filing of a claim prior to May 1, 1929, which complies with the requirements of Treasury Decision 4265, but (a) only the grounds set forth in such formal claim which were also set forth in such informal or defective claim will be considered, and (b) no claim in respect of which a suit in court has been commenced at any time may be so perfected.

ART. 1256. Claims for refund in case of judgment obtained against the United States.

T. D. 4262 (approved March 8, 1929)

Claims for the payment of judgments rendered by United States district courts and the United States Court of Claims against the United States representing taxes, penalties or other sums, should be executed on Form 843 in duplicate and filed directly with the Commissioner of Internal Revenue, Washington, D. C. The claimant should state the grounds of his claim under oath, giving the names of all parties to the suit, the cause of action, the date of its commencement, the date of the judgment, the court in which it was recovered, and its amount. To this affidavit there should be annexed two certified copies of the final judgment, and an itemized bill of the costs paid, receipted by the clerk or other proper officer of the court. In the case of a judgment rendered by the Court of Claims, there may be submitted in lieu of a certified copy of the final judgment, a certificate of judgment issued by the clerk of the court and two copies of the court's opinion, if any was rendered.

SEC. 613. LIEN FOR TAXES

T. D. 4275 (approved November 13, 1929)

Section 3186 of the Revised Statutes, as amended, is further amended by section 613 (entitled "Lien for taxes") of the Revenue Act of 1928 to read as follows:

SEC. 3186. (a) If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person. Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(b) Such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) In accordance with the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law provided for the filing of such notice; or

(2) In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law provided for the filing of such notice; or

(3) In the office of the clerk of the Supreme Court of the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(c) Subject to such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, the collector of internal revenue charged with an assessment in respect of any tax—

(1) May issue a certificate of release of the lien if the collector finds that the liability for the amount assessed, together with all interest in respect thereof, has been satisfied or has become unenforceable;

(2) May issue a certificate of release of the lien if there is furnished to the collector and accepted by him a bond that is conditioned upon the

payment of the amount assessed, together with all interest in respect thereof, within the time prescribed by law (including any extension of such time), and that is in accordance with such requirements relating to terms, conditions, and form of the bond and sureties thereon, as may be specified in the regulations;

(3) May issue a certificate of partial discharge of any part of the property subject to the lien if the collector finds that the fair market value of that part of such property remaining subject to the lien is at least double the amount of the liability remaining unsatisfied in respect of such tax and the amount of all prior liens upon such property.

(d) A certificate of release or of partial discharge issued under this section shall be held conclusive that the lien upon the property covered by the certificate is extinguished.

(e) The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation provide for the acceptance of a single bond complying both with the requirements of section 272 (j) of the Revenue Act of 1928 (relating to the extension of time for the payment of a deficiency), or of any similar provisions of any prior law, and the requirements of subsection (c) of this section.

(f) Subsections (c), (d), and (e) of this section shall apply to a lien in respect of any internal-revenue tax, whether or not the lien is imposed by this section.

In accordance with the provisions of subsections (c) and (e), supra, the following regulations are hereby prescribed:

The collector of internal revenue to whom is charged an assessment in respect of any internal-revenue tax shall issue a certificate of release of the tax lien whenever he finds that the liability for the amount assessed (together with all interest in respect thereof) has been satisfied or has become unenforceable. The word "unenforceable" as here used means unenforceable as a matter of law, and not merely uncollectible or unenforceable as a matter of fact. Tax liabilities frequently are unenforceable in fact for the time being, due to the temporary nonpossession by the taxpayer of discoverable property or property rights. In all cases the liability for the payment of the tax continues until satisfaction of the tax in full or until the expiration of the statutory period for collection, including such period as the taxpayer by consent in writing may agree with the Commissioner shall constitute the time within which the tax assessed may lawfully be collected. Collectors should continue to investigate carefully all cases of delinquent taxpayers where notice of lien has been filed, with a view of obtaining, before the expiration of the collection period, such written consent for the extension of the collection period, whenever it is reasonably possible that the taxpayer may, in the future, acquire property or property rights from which the tax liability may be satisfied.

The collector may in his discretion issue a certificate of release of the tax lien if he is furnished and accepts a bond that is conditioned upon the payment of the amount assessed (together with all interest in respect thereof) within the time agreed upon in the bond, but not later than six months prior to the expiration of the statutory period for collection, including any period for collection agreed upon in writing by the Commissioner and the taxpayer. The form of any bond so furnished shall be the standard form (Form 1131), entitled "Bond for release of Federal tax lien," and shall be executed by a surety company holding a certificate of authority from the Secretary of the Treasury as an acceptable surety on Federal bonds.

The collector may also in his discretion issue a certificate of discharge of any part of the property subject to the tax lien if he finds that the fair market value of the part of the property not released from such lien is at least double the amount of the existing liability in respect of such tax plus double the amount of all liens prior to that of the tax lien. In general, fair market value is that amount which one ready and willing but not compelled to buy would pay to another ready and willing but not compelled to sell the property. Collectors must be conservative in determining property values and should make careful inquiry with respect thereto.

In cases where the collector issues a certificate of release of tax lien and at the same time an extension of time is granted for the payment of the deficiency in tax pursuant to the provisions of section 272 (j) of the Revenue Act of 1928 or section 274 (k) or 308 (i) of the Revenue Act of 1926, a single bond may be accepted by the collector conditioned upon the payment of the amount assessed (together with all interest in respect thereof) in accordance with the terms of the extension and not later than six months prior to the expiration of the statutory period for collection, including any period for collection agreed upon in writing by the Commissioner and the taxpayer. Form 1131, hereinbefore mentioned, shall be used in these cases and shall be modified to meet the circumstances. Where a certificate of release of the tax lien has been issued by the collector, and the bond furnished to and accepted by the collector fully protects the interests of the United States with respect to the tax assessed, no additional bond will be required by the Commissioner as a condition to the granting of an extension of time for the payment of the deficiency in tax under the provisions of section 272 (j) of the Revenue Act of 1928 or section 274 (k) or 308 (i) of the Revenue Act of 1926.

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REGULATIONS 75

RELATING TO

CONSOLIDATED RETURNS OF AFFILIATED CORPORATIONS

PRESCRIBED UNDER SECTION 141(b) OF THE REVENUE ACT OF 1928

(Applicable to the taxable year 1929 and subsequent taxable years)

SECTION 141 OF THE REVENUE ACT OF 1928

Section 141 of the Revenue Act of 1928 provides as follows:

SEC. 141. CONSOLIDATED RETURNS OF CORPORATIONS—1929 AND SUBSEQUENT TAXABLE YEARS.

(a) Privilege to file consolidated returns.—An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

(b) Regulations.—The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability.

(c) Computation and payment of tax.—In any case in which a consolidated return is made the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the date on which such return is made. Only one specific credit, computed as provided in section 26(b), shall be allowed in computing the tax.

(d) **Definition of "affiliated group."**—As used in this section an "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if—

(1) At least 95 per centum of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per centum of the stock of at least one of the other corporations.

As used in this subsection the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(e) A consolidated return shall be made only for the domestic corporations within the affiliated group. An insurance company subject to the tax imposed by section 201 or 204 shall not be included in the same consolidated return with a corporation subject to the tax imposed by section 13.

(f) **China Trade Act corporations.**—A corporation organized under the China Trade Act, 1922, shall not be deemed to be affiliated with any other corporation within the meaning of this section.

(g) **Corporations deriving income from possessions of United States.**—For the purposes of this section a corporation entitled to the benefits of section 251, by reason of receiving a large percentage of its income from possessions of the United States, shall be treated as a foreign corporation.

(h) **Subsidiary formed to comply with foreign law.**—In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per centum of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this title as a domestic corporation.

(i) **Suspension of running of statute of limitations.**—If a notice under section 272(a) in respect of a deficiency for any taxable year is mailed to a corporation, the suspension of the running of the statute of limitations, provided in section 277, shall apply in the case of corporations with which such corporation made a consolidated return for such taxable year.

(j) **Allocation of income and deductions.**—For allocation of income and deductions of related trades or businesses, see section 45.

APPLICATION OF REGULATIONS

(*a*) *1929 and Subsequent Years.*

These regulations are applicable only to the taxable year 1929 and to subsequent taxable years.

(*b*) *1928 and Prior Years.*

The regulations applicable to the taxable year 1928 will be found as a part of Regulations 74 (arts. 731 to 735, inclusive), and the regulations applicable to the taxable year 1927 or any prior taxable year will be found in the prior regulations, and the amendments thereto.

(*c*) *Basis of Property Acquired through Intercompany Transactions during 1928 or Prior Years.*

The regulations prescribed under section 113(a)(12) of the Revenue Act of 1928, applicable to the basis, after the period of affiliation, of property acquired through an intercompany transaction, during the taxable year 1928 or any prior taxable year, will be found in Regulations 74 (art. 603).

INTERPRETATIONS OF SECTION 141

Interpretations of section 141 of the Act will be found in Regulations 74.[1]

AUTHORITY FOR REGULATIONS

The following regulations are hereby prescribed pursuant to the authority of section 141(b) of the Revenue Act of 1928.[2]

PART I.—GENERAL PROVISIONS

ARTICLE 1. **Privilege of Filing Consolidated Returns.**

(*a*) Section 141 gives to the corporations of an affiliated group the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. This privilege, however, is given upon the condition that *all* corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to these regulations, and any amendments thereof duly prescribed prior to the making of the return and applicable to such year; and the making of the consolidated return is considered as such consent.

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[1] Reprinted for convenience as an appendix to these regulations.

[2] The report of the Committee on Finance (S. Rept. No. 960, 70th Cong., 1st sess., p. 15) accompanying the Revenue Bill of 1928 contains the following statement (a similar statement being contained also in the statement of the managers on the part of the House, accompanying the conference report upon the bill, see H. Rept. No. 1882, 70th Cong., 1st sess., pp. 16–17):

"Among the regulations which it is expected that the commissioner will prescribe are: (1) The extent to which gain or loss shall be recognized upon the sale by a member of the affiliated group of stock issued by any other member of the affiliated group or upon the dissolution (whether partial or complete) of a member of the group; (2) the basis of property (including property included in an inventory) acquired, during the period of affiliation, by a member of the affiliated group, including the basis of such property after such period of affiliation; (3) the extent to which and the manner in which net losses sustained by a corporation before it became a member of the group shall be deducted in the consolidated return; and the extent to which and the manner in which net losses sustained during the period for which the consolidated return is filed shall be deducted in any taxable year after the affiliation is terminated in whole or in part; (4) the extent to which and the manner in which gain or loss is to be recognized, upon the withdrawal of one or more corporations from the group, by reason of transactions occurring during the period of affiliation; and (5) that the corporations filing the consolidated return must designate one of their members as the agent for the group, in order that all notices may be mailed to the agent, deficiencies collected, refunds made, interest computed, and proceedings before the Board of Tax Appeals conducted as though the agent were the taxpayer.

(*b*) The tax liability of the members of the affiliated group for such year will be determined in accordance with such regulations and without regard to any amendment thereto promulgated subsequent to the filing of such return.

ART. 2.—**Definitions.**

(*a*) *Act.*

The term "Act" means the Revenue Act of 1928.

(*b*) *Affiliated Group.*

The term "affiliated group" includes the common parent corporation and every other corporation for the period during which such corporation is a member of the affiliated group within the meaning of section 141 of the Act; but does not include any corporation which under section 141 can not be included in a consolidated return (for example, a foreign corporation or a corporation treated as a foreign corporation, except as provided in section 141(h); a corporation organized under the China Trade Act, 1922; an insurance company, in the case of a consolidated return for corporations subject to the tax imposed by section 13; or a corporation subject to the tax imposed by section 13, in the case of a consolidated return for insurance companies).

(*c*) *Consolidated Return Period.*

The term "consolidated return period" means the taxable year 1929, or any subsequent taxable year, for which a consolidated return is made or is required.

(*d*) *Subsidiary.*

The term "subsidiary" means a corporation (other than the common parent) which is a member of the affiliated group during any part of the consolidated return period.

(*e*) *Tax.*

The term "tax" includes any interest, penalty, additional amount, or addition to the tax, payable in respect thereof.

(*f*) *Terms defined in Revenue Act of 1928.*

Terms which are defined in the Act shall, when used in these regulations, have the meaning assigned to them by the Act, unless specifically otherwise defined. (See, for example, "net income," section 21; "gross income," section 22; "taxable year" and "fiscal year," section 48; "net loss," section 117; "deficiency," section 271; and the terms defined in section 701, particularly the terms "person," "stock," and "corporation.")

ART. 3.—**Applicability of other Provisions of Law.**

Any matter in the determination of which the provisions of these regulations are not applicable shall be determined in accordance with the provisions of the Act or other law applicable thereto.

PART II.—ADMINISTRATIVE PROVISIONS

ART. 10.—**Exercise of Privilege.**

(*a*) *Must be Exercised at Time Parent Files Return.*

The privilege of making a consolidated return for any taxable year of an affiliated group must be exercised at the time of filing the return of the parent corporation for such year. Under no circumstances can such privilege be exercised at any time thereafter. If the privilege is exercised at the time of filing the return, separate returns can not thereafter be filed for such year. (See, however, article 18, relating to the improper inclusion in the consolidated return of the income of a corporation.)

(*b*) *Effect of Tentative Returns.*

In no case will the privilege under paragraph (*a*) be considered as exercised at the time of filing a so-called "tentative return" (filed, for example, in order to obtain an extension of time for the filing of the return required by law). However, if any such tentative return is filed upon the basis of a consolidated return or a separate return, the return required by law must be filed upon the same basis, unless upon the filing of the return required by law (either a separate return or a consolidated return, as the case may be) the payments theretofore made and to be made are adjusted in a manner satisfactory to the Commissioner.

ART. 11.—**Consolidated Returns for Subsequent Years.**

(*a*) *Consolidated Returns Required for Subsequent Years.*

If a consolidated return is made for the taxable year 1929 or any taxable year thereafter, a consolidated return must be made for each subsequent taxable year during which the affiliated group remains in existence unless (1) a corporation (other than a corporation created or organized, directly or indirectly, by a member of the affiliated group) has become a member of the group during such subsequent taxable year, or (2) one or more provisions of these regulations, which have previously been consented to, have been amended, or (3) the Commissioner, prior to the time of filing the return, upon application made by the parent corporation and for good cause shown, grants permission to change.

(*b*) *Effect of Separate Returns When Consolidated Return Required.*

If the filing of a consolidated return is required for any taxable year, the tax liability of the members of the affiliated group shall be computed in the same manner as if a consolidated return had been filed, even though separate returns are filed; amounts assessed upon the basis of separate returns shall be considered as having been as-

sessed upon the basis of a consolidated return; and amounts paid upon the basis of separate returns shall be considered as having been paid by the parent corporation. In such cases the filing of separate returns shall not be considered as the filing of a return for the purpose of computing any period of limitation or any deficiency. If a consolidated return for such taxable year is thereafter filed, such return shall for the purpose of computing periods of limitation and any deficiency be considered as the return for such year.

(*c*) *When Affiliated Group Remains in Existence.*

For the purposes of these regulations, an affiliated group shall be considered as remaining in existence if the parent corporation remains as a parent and at least one subsidiary remains affiliated with it, whether or not such subsidiary was a member of the group at the time the group was formed and whether or not one or more corporations have become subsidiaries or have ceased to be subsidiaries at any time after the group was formed.

(*d*) *When Affiliated Group Terminates.*

For the purposes of these regulations, an affiliated group shall be considered as terminated if the parent corporation ceases to be the parent or if there is no subsidiary affiliated with it.

ART. 12.—**Filing Consolidated Return and other Forms.**

(*a*) *Consolidated Return Filed by Parent.*

A consolidated return shall be made on Form 1120 by the parent corporation for the affiliated group. Such return shall be filed, at the time and in the office of the collector of the district, prescribed for the filing of a separate return by such corporation. (See article 401 of Regulations 74.)

(*b*) *Authorizations and Consents Filed by Subsidiaries.*

Each subsidiary must prepare two duplicate originals of Form 1122, consenting to these regulations and authorizing the parent corporation to file a consolidated return on its behalf for the taxable year and authorizing the parent corporation (or, in the event of its failure, the Commissioner or the collector) to file a consolidated return on its behalf (as long as it remains a member of the group), for each year thereafter for which, under article 11 (*a*), the filing of a consolidated return is required. One of such forms shall be attached to the consolidated return, as a part thereof; and the other shall be filed, at or before the time the consolidated return is filed, in the office of the collector for the district prescribed for the filing of a separate return by such subsidiary. No such consent can be withdrawn or revoked at any time after the consolidated return is filed.

(*c*) *Affiliation Schedules Filed by Parent.*

The parent corporation must prepare Form 851 (Revised January, 1929—Affiliation Schedules), and such form must be attached to the consolidated return, as a part thereof.

(*d*) *Persons Qualified to Swear to Returns and Forms.*

Each return or form required to be made or prepared by a corporation must be sworn to by the persons then qualified to swear to a separate return of such corporation.

(*e*) *Signatures in case Subsidiary has left Group.*

It will be observed that Form 1122 is required even though the subsidiary (because of a dissolution or sale of stock, or otherwise) has ceased during the taxable year of the parent corporation to be a member of the group. Accordingly, it may be advisable for the parent corporation to obtain the signature to the form prior to the time the subsidiary ceases to be a member of the group.

ART. 13.—**Change in Affiliated Group During Taxable Year.**

(This article has no bearing upon the question as to whether a consolidated return may or must be filed, but relates only to the effect of changes in the affiliated group during the taxable year.)

(*a*) *General Rule.*

Except as hereinafter provided, a consolidated return must include the income of the parent and of each subsidiary for the entire taxable year.

(*b*) *Formation of Affiliated Group after Beginning of Year.*

If an affiliated group is formed after the beginning of the taxable year of the corporation which becomes the parent, the consolidated return must include the income of the parent for its entire taxable year (excluding, of course, any portion of such year during which its income is included in the consolidated return of another affiliated group) and the income of each subsidiary from the time it became a member of the group.

(*c*) *Complete Termination of Affiliated Group prior to Close of Taxable Year.*

If an affiliated group is terminated prior to the close of the taxable year of the group, the consolidated return must include the income of the parent for its entire taxable year (excluding any portion of such year during which its income is included in the consolidated return of another affiliated group) and of each subsidiary for the period prior to the termination. (See paragraphs (*c*) and (*d*) of article 11, in determining whether the group has terminated.)

(*d*) *Addition to Group of a Subsidiary during Year.*

If a corporation becomes a member of the affiliated group during the taxable year of the group, the consolidated return must include its income from the time it became a member of the group.

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(*e*) *Elimination from Group of a Subsidiary during Year.*

If a subsidiary ceases to be a member of the affiliated group during the taxable year of the group, the consolidated return must include its income for the period during which it was a member of the group.

(*f*) *Period of 30 days or Less may be Disregarded.*

A subsidiary may at its option be considered as having been a member of the affiliated group during the entire taxable year of the group (or during the entire period of the existence of the subsidiary, whichever is shorter) if the period during which it was not a member of such group does not exceed 30 days. If a corporation has been a member of the affiliated group for a period of less than 31 days during the taxable year of the group, it may at its option be considered as not having been a member of the group during the taxable year. An option under this paragraph must be exercised at or before the time the consolidated return is filed.

(*g*) *Separate Returns for Periods not Included in Consolidated Return.*

If a corporation, during its taxable year, becomes a member of an affiliated group, its income for the portion of such taxable year not included in the consolidated return of such group must be included in a separate return (or, if a member of another affiliated group which files a consolidated return for such period, then in such consolidated return). If a corporation ceases to be a member of the affiliated group during the taxable year of the group, its income for the period after the time it ceased to be a member of the affiliated group must be included in a separate return (or, if it becomes a member of another affiliated group which files a consolidated return for such period, then in such consolidated return).

(*h*) *Time for Filing Separate Returns for Periods not Included in Consolidated Return.*

If a corporation, during its taxable year, becomes a member of an affiliated group, the separate return required for the portion of its taxable year during which it was not a member of the group must be made on or before the fifteenth day of the third month following the close of its taxable year. For example, corporation P, reporting its income on a calendar year basis, acquires on January 1, 1929, all the stock of corporation S, which reports its income on a fiscal year basis ending March 31. P and S elect to file a consolidated return for the calendar year 1929. The separate return of S for the taxable period April 1, 1928, to December 31, 1928, should be filed on or before June 15, 1929.

ART. 14.—**Accounting Period of an Affiliated Group.**

The taxable year of the parent corporation shall be considered as the taxable year of an affiliated group which makes a consolidated return, and the consolidated net income must be computed on the basis of the taxable year of the parent corporation.

ART. 15.—**Liability for Tax.**

(*a*) *Several Liability of Members of Affiliated Group.*

Except as provided in paragraph (*b*), the parent corporation and each subsidiary, a member of the affiliated group during any part of a consolidated return period, shall be severally liable for the tax (including any deficiency in respect thereof) computed upon the consolidated net income of the group.

(*b*) *Liability of Subsidiary after Withdrawal.*

If a subsidiary by reason of a bona fide sale of stock for fair value has ceased to be a member of the affiliated group its liability under paragraph (*a*) shall remain unchanged, except that if such cessation occurred prior to the date upon which any such deficiency is assessed (other than by a jeopardy assessment), such deficiency in the case of such former subsidiary shall be reduced to an amount equal to such part as may be allocable to it upon the basis of the consolidated net income properly assignable to it. In no case, however, shall any demand for the payment of any deficiency be made, or any distraint or proceeding in court for the collection thereof be begun, against such former subsidiary prior to the determination by the Commissioner that the amount of the deficiency can not be collected from the parent corporation and the corporations (if any) remaining members of the affiliated group.

(*c*) *Effect of Intercompany Agreements.*

Any agreement entered into by one or more members of the affiliated group with any other members of such group or with any other person shall in no case have the effect of reducing the liability prescribed under this article.

(*d*) *Liability of Transferee not Affected.*

This article shall not be considered as extinguishing or diminishing any liability, at law or in equity, of a transferee of property of a taxpayer, including any liability under any provision of law, State or Federal, relating to liabilities pursuant to corporate dissolution or transfer or distribution of assets, whether or not in connection with a merger or consolidation.

ART. 16.—**Parent Agent for Subsidiaries.**

(*a*) *Scope of Agency of Parent.*

Except as provided in paragraphs (*b*) and (*c*) of this article (relating to the effect of the withdrawal of a subsidiary or the dissolution of the parent)—

The parent corporation shall be for all purposes, in respect of the tax for the taxable year for which a consolidated return is made or is

required, the agent of each corporation which during any part of such year was a member of the affiliated group, duly authorized in the name of the parent to act for and represent each such corporation in all matters relating to such tax; the parent corporation shall be the sole agent for such corporations in such matters; and such corporations shall not have authority to act for or represent themselves in any such matter. For example, all correspondence will be carried on directly with the parent; deficiency letters will be mailed only to the parent, and the mailing to the parent shall be considered as a mailing to each such corporation; the parent will file petitions and conduct proceedings before the Board of Tax Appeals, and any such petition shall be considered as having also been filed by each such corporation; the parent will file claims for refund or credit; refunds will be made directly to and in the name of the parent and will discharge any liability of the Government in respect thereof to any such corporation; and the parent in its name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed by each such corporation. Notwithstanding the provisions of this paragraph, however, any deficiency letter, in respect of the tax for a consolidated return period, will name each corporation which was a member of the affiliated group during any part of such period, and any assessment (whether of the original tax or of a deficiency) will be made in the name of each such corporation (but a failure to include the name of any such corporation will not affect the validity of the deficiency letter or the assessment as to the other corporations); and any notice or demand for payment, any distraint (or warrant in respect thereof), any levy (or notice in respect thereof), any notice of a lien, or any other proceeding to collect the amount of any assessment, after the assessment has been made, will name the corporation from which such collection is to be made. The provisions of this paragraph shall apply whether or not a consolidated return is made for any subsequent year, and whether or not one or more subsidiaries have become or have ceased to be members of the group at any time (but see paragraph (*b*) of this article).

(*b*) *Effect of Withdrawal of Subsidiary.*

For the purpose of the assertion, assessment, and collection of any deficiency, and of a credit or refund of any amount paid by a former subsidiary as a deficiency determined under article 15 (*b*), but for no other purpose, the agency of the parent corporation in respect of any subsidiary which has ceased to be a member of the affiliated

group shall be terminated upon the expiration of 30 days (or prior thereto if the Commissioner consents) from the date upon which the Commissioner receives notice from such subsidiary that it has ceased to be a member of the affiliated group and that it is terminating such agency. For example, if a subsidiary has ceased to be a member of the group (and if the 30-day period has expired) prior to the mailing of a deficiency letter to the parent, a separate deficiency letter will be mailed in due course to the subsidiary in respect of its deficiency if it becomes necessary to enforce its liability.

(*c*) *Effect of Dissolution of Parent.*

In the event that the parent corporation is contemplating dissolution, or is about to be dissolved, or if for any other reason its existence is about to terminate, it shall be its duty forthwith to notify the Commissioner of such fact and to designate another agent to act as agent in its place, to the same extent and subject to the same conditions and limitations as are applicable to the parent corporation. Until such notice in writing and such designation have been received by the Commissioner, any notice or deficiency letter mailed to the parent corporation shall be considered as having been properly mailed to the agent of the group; or, if the Commissioner has reason to believe that the existence of the parent corporation has terminated, he may, if he deems it advisable, deal directly with any member of the affiliated group in respect of its liability.

ART. 17.—**Waivers.**

(*a*) *Effect of Waiver given by Parent.*

Any consent given by the parent corporation (or by an agent in accordance with paragraph (*c*) of article 16) extending the time within which an assessment may be made or distraint or proceeding in court begun, in respect of the tax for a consolidated return period, shall be applicable (1) to each corporation which was a member of the affiliated group during any part of such period (whether or not any such corporation has ceased to be a member of the group), and (2) to each corporation the income of which was included in the consolidated return, or which filed Form 1122, for such period, even though it is subsequently determined that such corporation was not a member of the group.

(*b*) *Acceptance of Waivers from Parent and Alleged Subsidiary.*

In no case will a separate waiver be accepted from a corporation the income of which was included in the consolidated return (for example, a corporation which the Commissioner determines was not a member of the group), or which filed Form 1122, unless a waiver is also obtained from the parent corporation, or unless the Commissioner is dealing directly with such corporation to enforce its liability.

ART. 18.—**Failure to Comply with Regulations.**

(*a*) *Exclusion of a Subsidiary from Consolidated Return.*

If there has been a failure to include in the consolidated return the income of any subsidiary, or a failure to file any of the forms required by these regulations, notice thereof shall be given the parent corporation by the Commissioner, and the tax liability of each member of the affiliated group shall be determined on the basis of separate returns unless such income is included or such forms filed within the period prescribed in such notice, or any extension thereof, or unless under article 11 a consolidated return is required for such year.

(*b*) *Parent Incorrectly Designated in Consolidated Return.*

If a consolidated return includes a corporation as the parent and such corporation was not (under the provisions of section 141 of the Act) the parent, the tax liability of each corporation included in the return will be computed in the same manner as if separate returns had been filed, unless, upon application, the Commissioner approves the making of a consolidated return, or unless under article 11 a consolidated return is required for such year.

(*c*) *Inclusion of Subsidiary not a Member of Group.*

If a consolidated return includes a corporation as a subsidiary and such corporation was not a member of the affiliated group during the consolidated return period, the tax liability of such corporation will be determined upon the basis of a separate return and the consolidated return shall be considered as including only the corporations which were members of the affiliated group during such period.

(*d*) *Effect of Authorization and Consent Filed Pursuant to Notice.*

If Form 1122 is filed by any corporation, pursuant to a notice under paragraph (*a*) of this article, it shall be considered for all purposes as if such corporation had joined in the making of the consolidated return.

(*e*) *Allocation of Payments in the Event of Change to Separate Returns.*

In any case in which amounts have been assessed upon the basis of a consolidated return and the tax liabilities of the corporations included in the consolidated return are to be computed in the same manner as if separate returns had been filed, the assessments shall be adjusted, and such amounts shall be allocated to such corporations in such manner as they may agree upon or, in the absence of an agreement, allocated by the Commissioner to such corporations upon the basis of their net incomes as shown upon the consolidated return.

PART III.—COMPUTATION OF TAX, RECOGNITION OF GAIN OR LOSS, AND BASIS

ART. 30.—**Computation of Tax.**

(*a*) *Tax Computed on Consolidated Net Income of Group.*

In the case of an affiliated group which makes, or is required to make, a consolidated return for any taxable year, the tax liability of each corporation for the period during such year that it was a member of such group shall be computed upon the consolidated net income of the group, determined in accordance with these regulations. (See, however, article 15, relating to the liability of the members of the group.)

(*b*) *Allowance of Credit.*

For the allowance and the computation of the credit of $3,000, as provided in section 26 (b) of the Act, see Regulations 74.

ART. 31.—**Consolidated Net Income.**

(*a*) *Definition.*

Except as otherwise provided in these regulations, the consolidated net income of an affiliated group, which makes or is required to make a consolidated return for any taxable year, shall be the aggregate of the gross income of each of the members of such group less the aggregate of the allowable deductions of each of such members, except that gain or loss will not be recognized upon transactions between members of the group (referred to in these regulations as "intercompany transactions").

(*b*) *Statements and Schedules for Subsidiaries.*

The statement of gross income and deductions and the several schedules required by the instructions on the return must be prepared and filed by the parent corporation in columnar form so that the details of the items of gross income and deductions for each member of the consolidated group may be readily audited. Such statements and schedules shall include in columnar form a reconciliation of surplus for each such corporation, together with a reconciliation of the consolidated surplus. Consolidated balance sheets as of the beginning and close of the taxable year of the group, taken from the books of the group, shall accompany the consolidated return prepared in a form similar to that required for reconciliation of surplus.

ART. 32.—**Method of Computation of Net Income for Period of Less Than Twelve Months.**

If a corporation, during the taxable year of the group, becomes a member or ceases to be a member of an affiliated group which makes or is required to make a consolidated return for such year, the income

of such corporation to be included in the consolidated return shall be computed on the basis of its income as shown by its books (subject to the elimination of items exempt from taxation and the addition of items not allowable as deductions in computing net income) if the accounts are so kept that the income for the period during which it is a member of the group can be clearly and accurately determined. If the accounts are not so kept, the income to be included in the consolidated return shall be that portion of its income for the full taxable year which the number of days that its income to be included in the consolidated return bears to the number of days in the taxable year of such corporation; but any items of gain or loss which may clearly and accurately be determined to be attributable to transactions during such period shall be included in the consolidated return and shall not be apportioned.

ART. 33.—Gain or Loss from Sale of Stock or Bonds.

Gain or loss from the sale or other disposition (whether or not during a consolidated return period), by a corporation which during any period of time (after the beginning of the taxable year 1929) has been a member of an affiliated group which makes or is required to make a consolidated return, of any share of stock or any bond issued by another corporation which during any part of such period was a member of the same group, shall be determined, and the extent to which such gain or loss shall be recognized shall also be determined, in the same manner, to the same extent, and upon the same conditions as though such corporations had never been affiliated (see sections 111 to 115, inclusive, of the Act, and the regulations thereunder), except—

(1) In the case of a disposition (by sale, dissolution, or otherwise) during a consolidated return period to another member of the affiliated group (see articles 31 and 37); and

(2) The basis for determining the gain or loss, in the case of shares of stock held during any part of a consolidated return period, shall be determined in accordance with article 34; and

(3) As provided in articles 35 and 36 (imposing certain limitations upon losses otherwise allowable upon sales of stock or bonds).

ART. 34.—Sale of Stock—Basis for determining Gain or Loss.

(*a*) *Scope of Article.*

This article prescribes the basis for determining the gain or loss upon any sale or other disposition (hereinafter referred to as "sale") by a corporation which is (or has been) a member of an affiliated group which makes (or has made) a consolidated return for the taxable year 1929 or any subsequent taxable year, of any share of

stock issued by another member of such group (whether issued before or during the period that it was a member of the group and whether issued before, during, or after the taxable year 1929), and held by the selling corporation during any part of a consolidated return period. (For the basis in the case of sales of bonds, see article 35.) The paragraphs of this article are applicable to sales during different periods of time, as follows:

(1) Sales which do not break the affiliation—paragraph (*b*);

(2) Sales which break the affiliation and which are made during the period that the selling corporation is a member of the affiliated group (whether or not during a consolidated return period)—paragraph (*c*);

(3) Sales made after the selling corporation has ceased to be a member of the affiliated group—paragraph (*d*).

(*b*) *Sales which do not Break Affiliation.*

If notwithstanding any such sale the issuing corporation remains a member of the affiliated group, such basis shall be determined and adjusted in the same manner as if the selling corporation and the issuing corporation had never been members of an affiliated group. (See sections 111 to 115, inclusive, of the Act, and articles 561 to 629, inclusive, of Regulations 74.)

(*c*) *Sales which break Affiliation made while Selling Corporation is Member of Group.*

If the sale is made during a period during which the selling corporation is a member of the affiliated group (whether or not during a consolidated return period), and if, as a result of such sale, the issuing corporation ceases to be a member of the affiliated group, such basis shall be determined as follows:

(1) The aggregate basis of all shares of stock of the issuing corporation held by each member of the group (exclusive of the issuing corporation) immediately prior to the sale, shall be determined separately for each member of the group, and adjusted in accordance with the Act (see sections 111 to 115, inclusive, of the Act, and articles 561 to 629, inclusive, of Regulations 74);

(2) From the sum of the aggregate bases, as determined in paragraph (1) above, there shall be deducted the aggregate of the losses of such issuing corporation sustained during each of the consolidated return periods (including only the taxable year 1929 and subsequent taxable years) after such corporation became a member of the group and prior to the sale of the stock, to the extent that such losses could not have been availed of by such corporation as a net loss in computing its tax for such periods if it had made a separate return for each of such periods;

(3) The total aggregate basis of all shares of stock, after making the deduction under paragraph (2), shall then be allocated to each member of the group which holds stock in the issuing corporation, in the ratio that the basis of each, as determined under paragraph (1), is to the sum of the bases of all;

(4) The aggregate basis as determined under paragraph (3) for each member of the group shall then be equitably apportioned among the various classes of stock held by such member according to the circumstances of the case—ordinarily in the ratio that the basis of each class of stock held by it at the time of the sale is to the sum of the bases of each class of stock held by it;

(5) The basis of each share of stock of each class held by a member of the group shall then be determined by dividing the basis apportioned to such class under paragraph (4) by the total number of shares of such class held by it.

Examples:

Application of (c) (2) above

Corporations P and S are affiliated and file consolidated returns showing the following gains and losses (losses indicated by parentheses):

Year	P	S	Consolidated
1929	$100,000	($40,000)	$60,000
1930	40,000	10,000	50,000
1931	50,000	(20,000)	30,000
1932	40,000	25,000	65,000

January 1, 1933, P sells the stock of S. The adjustment to be made to the basis of the stock for losses sustained by S during the consolidated return periods is $30,000, computed as follows:

Loss for 1929	$40,000	
Less income for—		
1930	$10,000	
1931	None.	
	10,000	
		$30,000
Loss for 1931	$20,000	
Less income for 1932	25,000	None.
Total adjustment for losses		$30,000

Application of (c) (3) above

Corporations P, S_1, and S_2 are affiliated and file consolidated returns for 1929, 1930, and 1931. The investments in stocks of affiliated corporations are as follows:

	Common	Per cent
P stock S_1	$100,000	100
P stock S_2	50,000	50
S_1 stock S_2	50,000	50

January 1, 1932, P sells its stock in S_2. The aggregate basis of S_2's stock determined under paragraph (1) is $100,000. Assuming that the adjustment under paragraph (2) is $20,000, the total adjusted basis becomes $80,000. Proportioning this adjustment basis to P and S_1, in the ratio of the basis of each ($50,000) to the sum of the bases ($100,000), gives an adjusted basis to each of ($40,000).

(*d*) *Sales after Selling Corporation has ceased to be a Member of the Group.*

If the sale is made after the selling corporation has ceased to be a member of the affiliated group, such basis shall be determined in accordance with paragraph (*c*) of this article, except that—

(1) The aggregate basis (under subparagraph (1) of such paragraph) shall be determined for all shares of the issuing corporation held by each member of the group immediately prior to the time the selling corporation ceased to be a member of the group (rather than immediately prior to the sale); and

(2) The allocations (under subparagraph (3) of such article) shall be made to each member of the group which held stock of the issuing corporation immediately prior to the time the selling corporation ceased to be a member of the group (rather than to the members holding such stock at the time of the sale); and

(3) The basis of each share of stock held by the selling corporation (determined, as above, as of the time the selling corporation ceased to be a member of the group) shall then be adjusted in accordance with the Act (see, particularly, sections 111 to 115, inclusive, of the Act and articles 561 to 629, inclusive, of Regulations 74) in order to determine the basis at the time of the sale.

(*e*) *Limitation on Adjustment For Losses.*

No deduction shall be made under paragraph (*c*) (2) of this article, in the event of a consolidated net loss which was sustained more than two years prior to the close of the taxable year during which the sale was made and which was not availed of by the members of the affiliated group in computing the tax for the consolidated return period, for that portion of such net loss which the losses of the subsidiary for the year in which such net loss was sustained bears to the aggregate losses of each of the members of the group.

For example, corporations P and S are affiliated and file consolidated returns showing gains and losses, as follows:

Year	P	S	Consolidated
1929	($10,000)	($20,000)	($30,000)
1930	15,000	(18,000)	(3,000)
1931	10,000	(10,000)	None.
1932	12,000	8,000	20,000

January 1, 1933, P sells the stock of S. In computing the adjustment to be made to the basis of the stock of S under paragraph (*c*) (2), no adjustment will be made for the loss for 1929, since none of the consolidated loss for that year was availed of in computing the tax for the consolidated return periods.

(*f*) *Definition of "Losses" and "Net Losses."*

As used in this article the term "losses" means the excess of the allowable deductions over the gross income, determined in accordance with the provisions of the revenue act applicable to the period; and the term "net loss" means a net loss determined in accordance with the provisions of the revenue act applicable to the period.

ART. 35.—Sale of Bonds—Basis for determining Gain or Loss.

In the case of a sale or other disposition by a corporation, which is (or has been) a member of an affiliated group which makes (or has made) a consolidated return for the taxable year 1929 or any subsequent taxable year, of bonds issued by another member of such group (whether or not issued while it was a member of the group and whether issued before, during, or after the taxable year 1929), the basis of each bond, for determining the gain or loss upon such sale or other disposition, shall be determined in accordance with the Act (see, particularly, section 113 of the Act), but the amount of any loss otherwise allowable shall be decreased by the excess (if any) of the aggregate of the deductions computed under paragraph (*c*) (2) of article 34 over the aggregate of the basis of the stock of the issuing corporation as computed under paragraph (*c*) (1) or (*d*), as the case may be, held by the members of the affiliated group. (See, also, article 40 (*c*), relating to disallowance of loss upon intercompany bad debts.)

ART. 36.—Limitation on Allowable Losses on Sale of Stock or Bonds.

(*a*) *General Rule.*

No loss shall be allowed under article 33, 34, or 35 upon the sale or other disposition of stock or bonds to the extent that such loss is attributable to (1) transfers of assets within the affiliated group (by sale, gift, or otherwise) without consideration or at markedly fictitious values, during the period of affiliation (whether or not a consolidated return was filed and whether before or after the taxable year 1929) which result in reducing the value of the assets of such subsidiary (minus its liabilities) as of the time of such sale or other disposition substantially below the value of the assets of such subsidiary (minus its liabilities) at the time it became a member of the affiliated group, or (2) a distribution during a period of affiliation of earnings or profits accumulated prior to the date upon which the distributing corporation became a member of the affiliated group.

(*b*) *Qualification of General Rule.*

Nothing in paragraph (*a*) of this article shall be taken as in any way limiting the operation of the provisions of the Act relating to the basis for determining gain or loss upon the sale or other disposition of property (see sections 111 to 115, inclusive, and articles 561 to 629, inclusive, of Regulations 74), but is intended as in addition to and not in substitution for such provisions; subject, however, to this qualification: that to the extent that the transfers of assets referred to in paragraph (*a*) are taken into account under the terms of the Act in making adjustments in the basis, such transfers will not be taken into account in denying losses under paragraph (*a*).

ART. 37.—Dissolutions—Recognition of Gain or Loss.

(*a*) *During Consolidated Return Period.*

Gain or loss shall not be recognized upon a distribution during a consolidated return period, by a member of an affiliated group to another member of such group, in cancellation or redemption of all or any portion of its stock; and any such distribution shall be considered an intercompany transaction.

(*b*) *After Consolidated Return Period.*

Any such distribution after a consolidated return period, whether in complete or partial liquidation, shall be treated as a sale of the stock, and the adjustments specified in articles 34 and 35 will be made, and article 36 will be applicable.

ART. 38.—Basis of Property.

(*a*) *General Rule.*

Subject to the provisions of paragraph (*b*), the basis during a consolidated return period for determining the gain or loss from the sale or other disposition of property, or upon which exhaustion, wear and tear, obsolescence, and depletion are to be allowed, shall be determined and adjusted in the same manner as if the corporations were not affiliated (see sections 111 to 115, inclusive, of the Act), whether such property was acquired before or during a consolidated return period. Such basis immediately after a consolidated return period (whether the affiliation has been broken or whether the privilege to

file a consolidated return is not exercised) shall be the same as immediately prior to close of such period.

(*b*) *Intercompany Transactions.*

The basis prescribed in paragraph (*a*) shall not be affected by reason of a transfer during a consolidated return period (whether by sale, gift, dividend, upon dissolution, or otherwise) from a member of the affiliated group to another member of such group.

(*c*) *Basis not Affected by Acquisition or Sale of Stock.*

Neither the acquisition of stock of a corporation nor its sale or other disposition shall affect the basis of the property of such corporation for determining gain or loss or upon which exhaustion, wear and tear, obsolescence, and depletion are to be allowed.

ART. 39.—**Inventories.**

(*a*) *Consolidated Return Filed after Separate Return.*

Where a corporation has filed a separate return and in the succeeding taxable year is a member of an affiliated group which makes a consolidated return, the value of its opening inventory to be used in computing the consolidated net income for such succeeding taxable year shall be the proper value of the closing inventory used in computing its net income for the preceding taxable year. For example, corporation S filed a separate return for the taxable year 1928. It becomes a member of an affiliated group for the taxable year 1929. Its closing inventory for 1928 was $100,000. The opening inventory for 1929 will be $100,000, assuming that its closing inventory for 1928 was properly computed.

(*b*) *Separate Return Filed after Consolidated Return.*

If a corporation has been a member of an affiliated group which has filed a consolidated return and in the succeeding taxable year files a separate return, the value of the opening inventory to be used in computing its net income for such succeeding taxable year shall be the proper value of the closing inventory used in computing consolidated net income for the preceding taxable year. For example, corporation S filed a consolidated return for 1929 and a separate return for 1930. The proper value of its closing inventory for 1929 after eliminating intercompany profits was $90,000. Accordingly its opening inventory for computing its net income for 1930 will be $90,000.

ART. 40.—**Bad Debts.**

(*a*) *Resulting From Transactions During Consolidated Return Period.*

Intercompany accounts receivable or other obligations which are the result of intercompany transactions during a consolidated return period shall not be deducted as bad debts during a consolidated return period.

(*b*) *Resulting From Transactions Prior to Consolidated Return Period.*

No deduction shall be allowed during a consolidated return period for intercompany accounts receivable or other obligations resulting from intercompany transactions during the period of filing separate returns.

(*c*) *Limitation on Allowance after Consolidated Return Period.*

The rules applicable to the allowance of losses upon the sale of bonds shall be applicable to the allowance after the consolidated return period as a bad debt of an intercompany account receivable or other obligation resulting from an intercompany transaction during the consolidated return period. (See article 35.)

ART. 41.—**Net Losses.**

(*a*) *Consolidated Net Loss for 1929 or subsequent Taxable Year.*

A net loss sustained by an affiliated group for any taxable year (that is, 1929 or any subsequent taxable year) for which a consolidated return is made or is required shall be allowed, in the same manner, to the same extent, and upon the same conditions as if the group were a single corporation, as a deduction (1) in computing the consolidated net income of such group for the succeeding taxable years, or (2) if consolidated returns are not made or required, then in computing the net income of the parent corporation for such years, or (3) if the parent becomes a subsidiary in another affiliated group which makes a consolidated return, then in computing the consolidated net income of such other group for such years. In no case will any such net loss be allowed in computing the net income of a subsidiary (whether on a separate return or a consolidated return of another affiliated group of which the subsidiary has become a member).

(*b*) *Consolidated Net Loss for Years prior to 1929.*

A consolidated net loss sustained for either of the two taxable years immediately preceding the taxable year 1929, in the case of a parent corporation and one or more other corporations which made a consolidated return for such year, shall, if such parent is a member of an affiliated group which makes a consolidated return for the taxable year 1929 or the next succeeding taxable year, be allowed as a deduction in computing the consolidated net income of such group for 1929 or the next succeeding taxable year in the same manner, to the same extent, and upon the same conditions as if such group were a single corporation and the same taxpayer, except that no part of any such consolidated net loss which has previously been allowed, or is allowable, as a deduction in computing the net income of any such corporation which is not a member of such affiliated group during 1929 or the next succeeding taxable year, shall be allowed as a deduction in computing such consolidated net income for 1929 or the next

succeeding taxable year. In no case will any such consolidated net loss be allowed in computing the net income for the taxable year 1929 or the next succeeding taxable year of a subsidiary (whether on a separate return or a consolidated return of another affiliated group) which during any part of the taxable year 1929 or the next succeeding taxable year is a member of an affiliated group for which a consolidated return is made.

(*c*) *Net Loss Sustained by Separate Corporation Prior to Consolidated Return Period.*

A net loss sustained by a corporation prior to the date upon which its income is included in the consolidated return of an affiliated group (including any net loss sustained prior to the taxable year 1929) shall be allowed as a deduction in computing the consolidated net income of such group in the same manner, to the same extent, and upon the same conditions as if the consolidated income were the income of such corporation; but in no case in which the affiliated status is created after January 1, 1929, will any such net loss be allowed as a deduction in excess of the cost or the aggregate basis of the stock of such corporation owned by the members of the group.

(*d*) *Taxable Year.*

Any period of less than 12 months for which either a separate return or a consolidated return is filed, under the provisions of article 13, shall be considered as a taxable year.

ART. 42.—**Credit for Foreign Taxes.**

The credit allowed a domestic corporation for taxes paid or accrued during the consolidated return period to any foreign country or to any possession of the United States (under section 131 of the Act) shall be computed and allowed as if the affiliated group were the taxpayer.

ART. 43.—**Bases of Computation.**

In determining consolidated net income all members of the affiliated group shall adopt that method of accounting which clearly reflects the consolidated net income. A method of accounting which does not treat with reasonable consistency all items of gross income and deductions of the various members of the group shall not be regarded as clearly reflecting the consolidated net income. For example, one member of the group will not be permitted to report items of income or deductions on the cash basis of accounting, while another member of the same group reports the same or similar items on the accrual basis.

H. F. MIRES,
Acting Commissioner of Internal Revenue.

Approved January 3, 1929.

A. W. MELLON,
Secretary of the Treasury.

APPENDIX [REGULATIONS 75]

(Articles 711 to 715, inclusive, and article 735 of Regulations 74)

ART. 711. **Consolidated returns of affiliated corporations for 1929 and subsequent taxable years.**—The regulations prescribed under section 141 (b), and applicable to the making of consolidated returns by affiliated corporations for the taxable year 1929 and subsequent taxable years, and to the determination, computation, assessment, collection, and adjustment of tax liabilities under consolidated returns for such years, have been promulgated as Regulations 75. For convenience, Regulations 75 are reprinted in the appendix to these regulations. For definition of taxable year, see section 48.

ART. 712. **Formation of and changes in affiliated group.**—An affiliated group of corporations, within the meaning of section 141, is formed at the time that the common parent corporation becomes the owner directly of at least 95 per cent of the stock (as defined by section 141 (d)) of another corporation. A corporation becomes a member of an affiliated group at the time that one or more members of the group become the owners directly of at least 95 per cent of its stock. A corporation ceases to be a member of an affiliated group at the time that the aggregate of its stock owned directly by the members of the group becomes less than 95 per cent.

ART. 713. **Corporations to be included in consolidated returns for 1929 and subsequent taxable years.**—A consolidated return must include every domestic corporation which is a member of the affiliated group; but shall not include a foreign corporation (except as provided in section 141 (h) and article 714); a corporation organized under the China Trade Act, 1922; a corporation entitled to the benefits of section 251; or an insurance company subject to the tax imposed by section 201 or 204, in the case of a consolidated return for corporations subject to the tax imposed by section 13; or a corporation subject to the tax imposed by section 13, in the case of a consolidated return for insurance companies subject to the tax imposed by section 201 or 204.

ART. 714. **Foreign corporations which may be treated as domestic corporations.**—In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per cent of the capital stock (exclusive of directors' qualifying shares) of a corporation organized

under the laws of Canada or of Mexico and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for income tax purposes for 1928 and subsequent taxable years, as a domestic corporation. The option to treat such foreign corporation as a domestic corporation so that it may be included in a consolidated return must be exercised at the time of making the consolidated return.

ART. 715. **Allowance of specific credit.**—Only one specific credit of $3,000 (see section 26 (b) and article 301) shall be allowed against the consolidated net income of an affiliated group which makes a consolidated return, and this only in case the consolidated net income of the group does not exceed $25,000. If the consolidated net income of the group is more than $25,000, the tax imposed by section 13, 201, or 204 shall not exceed the tax which would be payable if the $3,000 credit were allowed, plus the amount of the net income in excess of $25,000. In cases where a consolidated return is made by an affiliated group for a fractional part of a year, the provisions of section 47 and article 371 are applicable. If the separate return of a corporation becoming a member or ceasing to be a member of an affiliated group making a consolidated return, is made for a period of less than 12 months, such return is for a fractional part of a year within the meaning of section 47 (e), and the specific credit of $3,000, if allowable, shall be reduced as therein provided. (See article 371.)

ART. 735.—**Taxable year of affiliated corporations making consolidated return.**—In the case of a consolidated return of affiliated corporations, the consolidated net income must be computed on the basis of the taxable year (calendar year or fiscal year) of any one of the affiliated corporations, except, if the affiliated group of corporations has a parent corporation, the consolidated net income must be computed upon the basis of the taxable year of the parent corporation. However, if the corporations properly made a consolidated return for the taxable year 1927, the consolidated net income for the taxable year 1928 must be computed on the basis of the same taxable year upon which the 1927 return was made, unless permission to change is granted by the Commissioner. If pursuant to this article the taxable year of a group of corporations affiliated under the provisions of section 142 (c) (2) would be a fiscal year beginning in 1928, a consolidated return for a fractional part of a year may be filed by such affiliated corporations for the period between the close of the previous fiscal year of the group and December 31, 1928. In such cases the period beginning January 1, 1929, shall be included in the return or returns for the taxable year 1929.

PRINCIPAL PROVISIONS OF THE REVENUE ACT OF 1926, THE REVENUE ACT OF 1924, AND THE REVISED STATUTES RELATING TO INCOME TAXES FOR 1928 AND SUBSEQUENT TAXABLE YEARS

REVENUE ACT OF 1926

RETURNS TO BE PUBLIC RECORDS

SEC. 257. [*Revenue Act of 1926.*] (a) Returns upon which the tax has been determined by the Commissioner shall constitute public records; but, except as hereinafter provided in this section and section 1203, they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President. Whenever a return is open to the inspection of any person a certified copy thereof shall, upon request, be furnished to such person under the rules and regulations prescribed by the Commissioner with the approval of the Secretary. The Commissioner may prescribe a reasonable fee for furnishing such copy.

(b) (1) The Secretary and any officer or employee of the Treasury Department, upon request from the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, or a select committee of the Senate or House specially authorized to investigate returns by a resolution of the Senate or House, or a joint committee so authorized by concurrent resolution, shall furnish such committee sitting in executive session with any data of any character contained in or shown by any return.

(2) Any such committee shall have the right, acting directly as a committee, or by or through such examiners or agents as it may designate or appoint, to inspect any or all of the returns at such times and in such manner as it may determine.

(3) Any relevant or useful information thus obtained may be submitted by the committee obtaining it to the Senate or the House, or to both the Senate and the House, as the case may be.

(c) The proper officers of any State may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe.

(d) All bona fide shareholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries. Any shareholder who pursuant to the provisions of this section is allowed to examine the

return of any corporation, and who makes known in any manner whatever not provided by law the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any such return, shall be guilty of a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both.

(e) The Commissioner shall as soon as practicable in each year cause to be prepared and made available to public inspection in such manner as he may determine, in the office of the collector in each internal-revenue district and in such other places as he may determine, lists containing the name and the post-office address of each person making an income-tax return in such district.

PUBLICATION OF STATISTICS

SEC. 258. [*Revenue Act of 1926.*] The Commissioner, with the approval of the Secretary, shall prepare and publish annually statistics reasonably available with respect to the operation of the income, war-profits and excess-profits tax laws, including classifications of taxpayers and of income, the amounts allowed as deductions, exemptions, and credits, and any other facts deemed pertinent and valuable.

PORTO RICO AND THE PHILIPPINE ISLANDS

SEC. 261. [*Revenue Act of 1926.*] In Porto Rico and the Philippine Islands the income tax shall be levied, assessed, collected, and paid as provided by law prior to the enactment of this Act.

The Porto Rican or the Philippine Legislature shall have power by due enactment to amend, alter, modify, or repeal the income tax laws in force in Porto Rico or the Philippine Islands, respectively.

COURT REVIEW OF BOARD'S DECISION

SEC. 1001. [*Revenue Act of 1926, as amended by section 603, Revenue Act of 1928.*] (a) The decision of the Board rendered after the enactment of this Act (except as provided in subdivision (j) of section 283 and in subdivision (h) of section 318) may be reviewed by a Circuit Court of Appeals, or the Court of Appeals of the District of Columbia, as hereinafter provided, if a petition for such review is filed by either the Commissioner or the taxpayer within six months after the decision is rendered.

(b) Such courts are authorized to adopt rules for the filing of such petition, the preparation of the record for review, and the conduct of proceedings upon such review and, until the adoption of such rules, the rules of such courts relating to appellate proceedings upon a writ of error, so far as applicable, shall govern.

(c) Notwithstanding any provision of law imposing restrictions on the assessment and collection of deficiencies, such review shall not operate as a stay of assessment or collection of any portion of the amount of the deficiency determined by the Board unless a petition for review in respect of such portion is duly filed by the taxpayer, and then only if the taxpayer (1) on or before the time his petition for review is filed has filed with the Board a bond in a sum

fixed by the Board not exceeding double the amount of the portion of the deficiency in respect of which the petition for review is filed, and with surety approved by the Board, conditioned upon the payment of the deficiency as finally determined, together with any interest, additional amounts, or additions to the tax provided for by law, or (2) has filed a jeopardy bond under the income or estate tax laws. If as a result of a waiver of the restrictions on the assessment and collection of a deficiency any part of the amount determined by the Board is paid after the filing of the review bond, such bond shall, at the request of the taxpayer, be proportionately reduced.

(d) In cases where assessment or collection has not been stayed by the filing of a bond, then if the amount of the deficiency determined by the Board is disallowed in whole or in part by the court, the amount so disallowed shall be credited or refunded to the taxpayer, without the making of claim therefor, or, if collection has not been made, shall be abated.

(e) Nothing in subdivision (c) shall be construed as relieving the petitioner from making or filing such undertakings as the court may require as a condition of or in connection with the review.

VENUE

SEC. 1002. [*Revenue Act of 1926.*] Such decision may be reviewed—

(a) In the case of an individual, by the Circuit Court of Appeals for the circuit whereof he is an inhabitant, or if not an inhabitant of any circuit, then by the Court of Appeals of the District of Columbia.

(b) In the case of a person (other than an individual), except as provided in subdivision (c), by the Circuit Court of Appeals for the circuit in which is located the office of the collector to whom such person made the return, or in case such person made no return, then by the Court of Appeals of the District of Columbia.

(c) In the case of a corporation which had no principal place of business or principal office or agency in the United States, then by the Court of Appeals of the District of Columbia.

(d) In the case of an agreement between the Commissioner and the taxpayer, then by the Circuit Court of Appeals for the circuit, or the Court of Appeals of the District of Columbia, as stipulated in such agreement.

JURISDICTION

SEC. 1003. [*Revenue Act of 1926.*] (a) The Circuit Courts of Appeals and the Court of Appeals of the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board (except as provided in section 239 of the Judicial Code, as amended); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judicial Code, as amended.

(b) Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.

SEC. 1004. [*Revenue Act of 1926.*] (a) The Circuit Courts of Appeals, the Court of Appeals of the District of Columbia, and the Supreme Court shall have power to impose damages in any case where the decision of the Board is affirmed and it appears that the petition was filed merely for delay.

(b) The Board is authorized to fix a fee, not in excess of the fee fixed by law to be charged and collected therefor by the clerks of the district courts, for comparing, or for preparing and comparing, a transcript of the record.

DATE ON WHICH BOARD'S DECISION BECOMES FINAL

SEC. 1005. [*Revenue Act of 1926.*] (a) The decision of the Board shall become final—

(1) Upon the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time; or

(2) Upon the expiration of the time allowed for filing a petition for certiorari, if the decision of the Board has been affirmed or the petition for review dismissed by the Circuit Court of Appeals and no petition for certiorari has been duly filed; or

(3) Upon the denial of a petition for certiorari, if the decision of the Board has been affirmed or the petition for review dismissed by the Circuit Court of Appeals; or

(4) Upon the expiration of 30 days from the date of issuance of the mandate of the Supreme Court, if such Court directs that the decision of the Board be affirmed or the petition for review dismissed.

(b) If the Supreme Court directs that the decision of the Board be modified or reversed, the decision of the Board rendered in accordance with the mandate of the Supreme Court shall become final upon the expiration of 30 days from the time it was rendered, unless within such 30 days either the Commissioner or the taxpayer has instituted proceedings to have such decision corrected to accord with the mandate, in which event the decision of the Board shall become final when so corrected.

(c) If the decision of the Board is modified or reversed by the Circuit Court of Appeals, and if (1) the time allowed for filing a petition for certiorari has expired and no such petition has been duly filed, or (2) the petition for certiorari has been denied, or (3) the decision of the Court has been affirmed by the Supreme Court, then the decision of the Board rendered in accordance with the mandate of the Circuit Court of Appeals shall become final on the expiration of 30 days from the time such decision of the Board was rendered, unless within such 30 days either the Commissioner or the taxpayer has instituted proceedings to have such decision corrected so that it will accord with the mandate, in which event the decision of the Board shall become final when so corrected.

(d) If the Supreme Court orders a rehearing; or if the case is remanded by the Circuit Court of Appeals to the Board for a rehearing, and if (1) the time allowed for filing a petition for certiorari has expired, and no such petition has been duly filed, or (2) the petition for certiorari has been denied, or (3) the decision of the court has been affirmed by the Supreme Court, then the decision of

the Board rendered upon such rehearing shall become final in the same manner as though no prior decision of the Board had been rendered.

(e) As used in this section—

(1) The term "Circuit Court of Appeals" includes the Court of Appeals of the District of Columbia;

(2) The term "mandate," in case a mandate has been recalled prior to the expiration of 30 days from the date of issuance thereof, means the final mandate.

EXAMINATION OF BOOKS AND WITNESSES

SEC. 1104. [*Revenue Act of 1926, as amended by section 618, Revenue Act of 1928.*] The Commissioner, for the purpose of ascertaining the correctness of any return or for the purpose of making a return where none has been made, is hereby authorized, by any officer or employee of the Bureau of Internal Revenue, including the field service, designated by him for that purpose, to examine any books, papers, records, or memoranda bearing upon the matters required to be included in the return, and may require the attendance of the person rendering the return or of any officer or employee of such person, or the attendance of any other person having knowledge in the premises, and may take his testimony with reference to the matter required by law to be included in such return, with power to administer oaths to such person or persons.

UNNECESSARY EXAMINATIONS

SEC. 1105. [*Revenue Act of 1926.*] No taxpayer shall be subjected to unnecessary examinations or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Commissioner, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

ADMINISTRATIVE REVIEW

SEC. 1107. [*Revenue Act of 1926.*] In the absence of fraud or mistake in mathematical calculation, the findings of facts in and the decision of the Commissioner upon (or in case the Secretary is authorized to approve the same, then after such approval) the merits of any claim presented under or authorized by the internal-revenue laws shall not, except as provided in Title IX of the Revenue Act of 1924, as amended, be subject to review by any other administrative or accounting officer, employee, or agent of the United States.

RETROACTIVE REGULATIONS

SEC. 1108. (a) [*Revenue Act of 1926, as amended by section 605, Revenue Act of 1928.*] In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or

Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.

LIMITATION ON PROSECUTIONS BY THE UNITED STATES

SEC. 1110. [*Revenue Act of 1926.*] (a) The Act entitled "An Act to limit the time within which prosecutions may be instituted against persons charged with violating internal-revenue laws," approved July 5, 1884, as amended, is reenacted without change, as follows:

"That no person shall be prosecuted, tried, or punished for any of the various offenses arising under the internal revenue laws of the United States unless the indictment is found or the information instituted within three years next after the commission of the offense: *Provided*, That for offenses involving the defrauding or attempting to defraud the United States or any agency thereof, whether by conspiracy or not, and in any manner, the period of limitation shall be six years, but this proviso shall not apply to acts, offenses, or transactions which were barred by law at the time of the enactment of the Revenue Act of 1924: *Provided further*, That the time during which the person committing the offense is absent from the district wherein the same is committed shall not be taken as any part of the time limited by law for the commencement of such proceedings: *Provided further*, That the provisions of this Act shall not apply to offenses committed prior to its passage: *Provided further*, That where a complaint shall be instituted before a commissioner of the United States within the period above limited, the time shall be extended until the discharge of the grand jury at its next session within the district: *And provided further*, That this Act shall not apply to offenses committed by officers of the United States."

(b) Any prosecution or proceeding under an indictment found or information instituted prior to the enactment of the Revenue Act of 1921 shall not be affected in any manner by this section, nor by the amendment by the Revenue Act of 1921 of such Act of July 5, 1884, but such prosecution or proceeding shall be subject to the limitations imposed by law prior to the enactment of the Revenue Act of 1921.

PENALTIES

SEC. 1114. [*Revenue Act of 1926.*] (c) Any person who willfully aids or assists in, or procures, counsels, or advises, the preparation or presentation under, or in connection with any matter arising under, the internal-revenue laws, of a false or fraudulent return, affidavit, claim, or document, shall (whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document) be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution.

(e) Any person in possession of property, or rights to property, subject to distraint, upon which a levy has been made, shall, upon demand by the collector or deputy collector making such levy, surrender such property or rights to such collector or deputy, unless such property or right is, at the time of such demand, subject to an attachment or execution under any judicial process. Any person who fails or refuses to so surrender any of such property or rights shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes (including penalties and interest) for the collection of which such levy has been made, together with costs and interest from the date of such levy.

(f) The term "person" as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

PAYMENT OF AND RECEIPTS FOR TAXES

SEC. 1118. [*Revenue Act of 1926.*] (a) Collectors may receive, at par with an adjustment for accrued interest, notes or certificates of indebtedness issued by the United States and uncertified checks in payment of income, war-profits, and excess-profits taxes and any other taxes payable other than by stamp, during such time and under such rules and regulations as the Commissioner, with the approval of the Secretary, shall prescribe; but if a check so received is not paid by the bank on which it is drawn the person by whom such check has been tendered shall remain liable for the payment of the tax and for all legal penalties and additions to the same extent as if such check had not been tendered.

JURISDICTION OF COURTS

SEC. 1122. [*Revenue Act of 1926.*] (c) The paragraph added by section 1310 of the Revenue Act of 1921 at the end of paragraph Twentieth of section 24 of the Judicial Code, relating to the jurisdiction of district courts, as amended, is reenacted without change, as follows:

"Concurrent with the Court of Claims, of any suit or proceeding, commenced after the passage of the Revenue Act of 1921, for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected, under the internal-revenue laws, even if the claim exceeds $10,000, if the collector of internal revenue by whom such tax, penalty, or sum was collected is dead or is not in office as collector of internal revenue at the time such suit or proceeding is commenced."

FRAUDS ON PURCHASERS

SEC. 1123. [*Revenue Act of 1926.*] Whoever in connection with the sale or lease, or offer for sale or lease, of any article, or for the purpose of making such sale or lease, makes any statement, written or oral, (1) intended or calculated to lead any person to believe that any part of the price at which such article is sold or leased, or offered for sale or lease, consists of a tax imposed under the authority of the United States, or (2) ascribing a particular part of such price to a tax imposed under the authority of the United States, knowing that such statement is false or that the tax is not so great as the portion of such

price ascribed to such tax, shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not more than $1,000 or by imprisonment not exceeding one year, or both.

DEPOSIT OF UNITED STATES BONDS OR NOTES IN LIEU OF SURETY

SEC. 1126. [*Revenue Act of 1926.*] Wherever by the laws of the United States or regulations made pursuant thereto, any person is required to furnish any recognizance, stipulation, bond, guaranty, or undertaking, hereinafter called "penal bond," with surety or sureties, such person may, in lieu of such surety or sureties, deposit as security with the official having authority to approve such penal bond, United States Liberty bonds or other bonds or notes of the United States in a sum equal at their par value to the amount of such penal bond required to be furnished, together with an agreement authorizing such official to collect or sell such bonds or notes so deposited in case of any default in the performance of any of the conditions or stipulations of such penal bond. The acceptance of such United States bonds or notes in lieu of surety or sureties required by law shall have the same force and effect as individual or corporate sureties, or certified checks, bank drafts, post-office money orders, or cash, for the penalty or amount of such penal bond. The bonds or notes deposited hereunder and such other United States bonds or notes as may be substituted therefor from time to time as such security, may be deposited with the Treasurer of the United States, a Federal reserve bank, or other depositary duly designated for that purpose by the Secretary, which shall issue receipt therefor, describing such bonds or notes so deposited. As soon as security for the performance of such penal bond is no longer necessary, such bonds or notes so deposited shall be returned to the depositor: *Provided*, That in case a person or persons supplying a contractor with labor or material as provided by the Act of Congress, approved February 24, 1905 (33 Stat. 811), entitled "An Act to amend an Act approved August thirteenth, eighteen hundred and ninety-four, entitled 'An Act for the protection of persons furnishing materials and labor for the construction of public works,'" shall file with the obligee, at any time after a default in the performance of any contract subject to said Acts, the application and affidavit therein provided, the obligee shall not deliver to the obligor the deposited bonds or notes nor any surplus proceeds thereof until the expiration of the time limited by said Acts for the institution of suit by such person or persons, and, in case suit shall be instituted within such time, shall hold said bonds or notes or proceeds subject to the order of the court having jurisdiction thereof: *Provided further*, That nothing herein contained shall affect or impair the priority of the claim of the United States against the bonds or notes deposited or any right or remedy granted by said Acts or by this section to the United States for default upon any obligation of said penal bond: *Provided further*, That all laws inconsistent with this section are hereby so modified as to conform to the provisions hereof: *And provided further*, That nothing contained herein shall affect the authority of courts over the security, where such bonds are taken as security in judicial proceedings, or the authority of any administrative officer of the United States to receive United States bonds for security in cases authorized by existing laws. The Secretary may prescribe rules and regulations necessary and proper for carrying this section into effect.

DATE ON WHICH DISTRAINT IS BEGUN

SEC. 1130. [*Revenue Act of 1926.*] In determining the running of any period of limitation in respect of distraint, the distraint shall be held to have been begun (a) in the case of personal property, on the date on which the levy upon such property is made, or (b) in the case of real property, on the date on which notice of the time and place of sale is given to the person whose estate it is proposed to sell.

BUREAU OF INTERNAL REVENUE

SEC. 1201. [*Revenue Act of 1926.*] (a) There is hereby created in the Department of the Treasury the office of General Counsel for the Bureau of Internal Revenue. The General Counsel shall be appointed by the President, by and with the advice and consent of the Senate, and shall receive a salary at the rate of $10,000 per annum, payable out of any appropriation available for the payment of expenses of assessing and collecting the internal-revenue taxes. He shall perform such duties as are now required under the internal revenue laws to be performed by the Solicitor of Internal Revenue, or as may be prescribed by the Secretary or required by law. Commencing at such time as the General Counsel first appointed under this section qualifies and takes office, the office of Solicitor of Internal Revenue in the Department of Justice shall cease to exist.

(b) There shall be in the Bureau of Internal Revenue the following officers who shall be appointed by the President, by and with the advice and consent of the Senate, and who shall perform such duties as may be prescribed by the Commissioner or required by law:

(1) Four Assistant General Counsel each of whom shall receive a salary at the rate of $8,000 per annum.

(2) One Assistant to the Commissioner who shall receive a salary at the rate of $8,000 per annum. The office of Assistant to the Commissioner provided by existing law is abolished to take effect at such time as the Assistant to the Commissioner first appointed under this section takes office.

(3) One Special Deputy Commissioner who shall receive a salary at the rate of $7,500 per annum.

JOINT CONGRESSIONAL COMMITTEE ON INTERNAL-REVENUE TAXATION

SEC. 1203. [*Revenue Act of 1926.*] (a) There is hereby established a joint congressional committee to be known as the Joint Committee on Internal Revenue Taxation (hereinafter in this section referred to as the "Joint Committee"), and to be composed of ten members as follows:

(1) Five members who are members of the Committee on Finance of the Senate, three from the majority and two from the minority party, to be chosen by such Committee; and

(2) Five members who are members of the Committee on Ways and Means of the House of Representatives, three from the majority and two from the minority party, to be chosen by such Committee.

(b) No person shall continue to serve as a member of the Joint Committee after he has ceased to be a member of the Committee by which he was chosen, except that the members chosen by the Committee on Ways and Means who have been re-elected to the House of Representatives may continue to serve as members of the Joint Committee notwithstanding the expiration of the Congress. A vacancy in the Joint Committee shall not affect the power of the remaining members to execute the functions of the Joint Committee, and shall be filled in the same manner as the original selection, except that (1) in case of a vacancy during an adjournment or recess of Congress for a period of more than two weeks, the members of the Joint Committee who are members of the Committee entitled to fill such vacancy may designate a member of such Committee to serve until his successor is chosen by such Committee, and (2) in the case of a vacancy after the expiration of a Congress which would be filled by the Committee on Ways and Means, the members of such Committee who are continuing to serve as members of the Joint Committee may designate a person who, immediately prior to such expiration, was a member of such Committee and who is re-elected to the House of Representatives, to serve until his successor is chosen by such Committee.

(c) It shall be the duty of the Joint Committee—

(1) To investigate the operation and effects of the Federal system of internal-revenue taxes;

(2) To investigate the administration of such taxes by the Bureau of Internal Revenue or any executive department, establishment, or agency, charged with their administration;

(3) To make such other investigations in respect of such system of taxes as the Joint Committee may deem necessary;

(4) To investigate measures and methods for the simplification of such taxes, particularly the income tax;

(5) To publish, from time to time, for public examination and analysis, proposed measures and methods for the simplification of such taxes, and to make to the Senate and the House of Representatives, not later than December 31, 1927, a definite report thereon, together with such recommendations as it may deem advisable; and

(6) To report, from time to time, to the Committee on Finance and the Committee on Ways and Means and, in its discretion, to the Senate or the House of Representatives, or both, the results of its investigations, together with such recommendations as it may deem advisable.

(d) The Joint Committee shall have the same right to obtain data and to inspect returns as the Committee on Ways and Means or the Committee on Finance, and to submit any relevant or useful information thus obtained to the Senate, the House of Representatives, the Committee on Ways and Means, or the Committee on Finance. The Committee on Ways and Means or the Committee on Finance may submit such information to the House or to the Senate, or to both the House and the Senate, as the case may be.

(e) The Joint Committee shall meet and organize as soon as practicable after at least a majority of the members have been chosen, and shall elect a chairman and vice chairman from among its members and shall have power to appoint and fix the compensation of a clerk and such experts and clerical, stenographic, and other assistants, as it deems advisable.

(f) The Joint Committee, or any subcommittee thereof, is authorized to hold hearings and to sit and act at such places and times, to require by subpœna or otherwise the attendance of such witnesses and the production of such books, papers, and documents, to administer such oaths, to take such testimony, to have such printing and binding done, and to make such expenditures, as it deems advisable. The cost of stenographic services in reporting such hearings shall not be in excess of 25 cents per hundred words. Subpœnas for witnesses shall be issued under the signature of the chairman or vice chairman.

(g) The members shall serve without compensation in addition to that received for their services as Members of Congress; but they shall be reimbursed for travel, subsistence, and other necessary expenses incurred by them in the performance of the duties vested in the Joint Committee, other than expenses in connection with meetings of the Joint Committee held in the District of Columbia during such times as the Congress is in session.

(h) The expenses of the Joint Committee shall be paid one-half from the contingent fund of the Senate and one-half from the contingent fund of the House of Representatives, upon vouchers signed by the chairman or vice chairman.

SAVING CLAUSE IN EVENT OF UNCONSTITUTIONALITY

SEC. 1213. [*Revenue Act of 1926.*] If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of the Act, and the application of such provision to other persons or circumstances, shall not be affected thereby.

REVENUE ACT OF 1924

MEMBERSHIP OF BOARD

SEC. 900. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] The Board of Tax Appeals (hereinafter referred to as the "Board") is hereby continued as an independent agency in the Executive Branch of the Government. The Board shall be composed of sixteen members; except that such limitation shall not be held applicable to any member holding office under an appointment made before the enactment of the Revenue Act of 1926, in accordance with the law in force prior to the enactment of such Act.

SEC. 901. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] (a) Members of the Board shall be appointed by the President, by and with the advice and consent of the Senate, solely on the grounds of fitness to perform the duties of the office. Members of the Board may be removed by the President, after notice and opportunity for public hearing, for inefficiency, neglect of duty, or mal-

feasance in office, but for no other cause. Each member shall receive salary at the rate of $10,000 per annum.

(b) The terms of office of all members who are to compose the Board prior to June 2, 1926, shall expire at the close of business on June 1, 1926. The terms of office of the sixteen members first taking office after such date shall expire, as designated by the President at the time of nomination, four at the end of the sixth year, four at the end of the eighth year, four at the end of the tenth year, and four at the end of the twelfth year, after June 2, 1926. The terms of office of all successors shall expire twelve years after the expiration of the terms for which their predecessors were oppointed; but any member appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed only for the unexpired term of his predecessor.

SEC. 902. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] A member of the Board removed from office in accordance with subdivision (a) of section 901 shall not be permitted at any time to practice before the Board.

ORGANIZATION AND PROCEDURE

SEC. 903. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] The Board shall at least biennially designate a member to act as chairman. The Board shall have a seal which shall be judicially noticed.

SEC. 904. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] The Board and its divisions shall have such jurisdiction as is conferred on them by Title II and Title III of the Revenue Act of 1926 or by subsequent laws. The Board is authorized to impose a fee in an amount not in excess of $10 to be fixed by the Board for the filing of any petition for the redetermination of a deficiency after the enactment of the Revenue Act of 1926 and for the hearing of any proceeding pending at the time of such enactment.

SEC. 905. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] A majority of the members of the Board or of any division thereof shall constitute a quorum for the transaction of the business of the Board or of the division, respectively. A vacancy in the Board or in any division thereof shall not impair the powers nor affect the duties of the Board or division nor of the remaining members of the Board or division, respectively.

SEC. 906. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926, and further amended by section 601, Revenue Act of 1928.*] (a) The chairman may from time to time divide the Board into divisions of one or more members, assign the members of the Board thereto, and in case of a division of more than one member, designate the chief thereof. If a division, as a result of a vacancy or the absence or inability of a member assigned thereto to serve thereon, is composed of less than the number of members designated for the division, the chairman may assign other members to the division or direct the division to proceed with the transaction of business without awaiting any additional assignment of members thereto. A division shall hear, and make a determination upon, any proceeding instituted before the

Board and any motion in connection therewith, assigned to such division by the chairman, and shall make a report of any such determination which constitutes its final disposition of the proceeding.

(b) The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. Any preliminary action by a division which does not form the basis for the entry of the final decision shall not be subject to review by the Board except in accordance with such rules as the Board may prescribe. The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board.

(c) If a petition for a redetermination of a deficiency has been filed by the taxpayer, a decision of the Board dismissing the proceeding shall be considered as its decision that the deficiency is the amount determined by the Commissioner. An order specifying such amount shall be entered in the records of the Board unless the Board can not determine such amount from the record in the proceeding, or unless the dismissal is for lack of jurisdiction.

(d) A decision of the Board (except a decision dismissing a proceeding for lack of jurisdiction) shall be held to be rendered upon the date that an order specifying the amount of the deficiency is entered in the records of the Board. If the Board dismisses a proceeding for reasons other than lack of jurisdiction and is unable from the record to determine the amount of the deficiency determined by the Commissioner, or if the Board dismisses a proceeding for lack of jurisdiction, an order to that effect shall be entered in the records of the Board, and the decision of the Board shall be held to be rendered upon the date of such entry.

(e) If the assessment or collection of any tax is barred by any statute of limitations, the decision of the Board to that effect shall be considered as its decision that there is no deficiency in respect of such tax.

(f) The findings of the Board made in connection with any decision prior to the enactment of the Revenue Act of 1926 shall, notwithstanding the enactment of such Act, continue to be prima facie evidence of facts therein stated.

SEC. 907. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926, and further amended by section 601, Revenue Act of 1928.*] (a) Notice and opportunity to be heard upon any proceeding instituted before the Board shall be given to the taxpayer and the Commissioner, and a report upon the proceeding and a decision thereon shall be made as quickly as practicable. The decision shall be made by a member in accordance with the report of the Board, and such decision so made shall, when entered, be the decision of the Board. If an opportunity to be heard upon the proceeding is given before a division of the Board, neither the taxpayer nor the Commissioner shall be entitled to notice and opportunity to be heard before the Board upon review, except upon a specific order of the chairman. Hearings before the Board and its divisions shall be open to the public, and the testimony, and, if the Board so requires, the argument shall

be stenographically reported. The Board is authorized to contract (by renewal of contract or otherwise) for the reporting of such hearings, and in such contract to fix the terms and conditions under which transcripts will be supplied by the contractor to the Board and to other persons and agencies. The proceedings of the Board and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Board may prescribe and in accordance with the rules of evidence applicable in courts of equity of the District of Columbia. In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, where no hearing has been held before the enactment of the Revenue Act of 1928, the burden of proof in respect of such issue shall be upon the Commissioner. The mailing by registered mail of any pleading, decision, order, notice, or process in respect of proceedings before the Board shall be held sufficient service of such pleading, decision, order, notice, or process.

(b) It shall be the duty of the Board and of each division to include in its report upon any proceeding its findings of fact or opinion or memorandum opinion. The Board shall report in writing all its findings of fact, opinions and memorandum opinions.

(c) All reports of the Board and all evidence received by the Board and its divisions, including a transcript of the stenographic report of the hearings, shall be public records open to the inspection of the public; except that after the decision of the Board in any proceeding has become final the Board may, upon motion of the taxpayer or the Commissioner, permit the withdrawal by the party entitled thereto of originals of books, documents, and records, and of models, diagrams, and other exhibits, introduced in evidence before the Board or any division; or the Board may, on its own motion, make such other disposition thereof as it deems advisable.

(d) The Board shall provide for the publication of its reports at the Government Printing Office in such form and manner as may be best adapted for public information and use, and such authorized publication shall be competent evidence of the reports of the Board therein contained in all courts of the United States and of the several States without any further proof or authentication thereof. Such reports shall be subject to sale in the same manner and upon the same terms as other public documents.

(e) The principal office of the Board shall be in the District of Columbia, but the Board or any of its divisions may sit at any place within the United States. The times and places of the meetings of the Board and of its divisions shall be prescribed by the chairman with a view to securing reasonable opportunity to taxpayers to appear before the Board or any of its divisions, with as little inconvenience and expense to taxpayers as is practicable.

(f) The Secretary of the Treasury shall provide the Board with suitable rooms in courthouses or other buildings when necessary for hearings by the Board, or any division thereof, outside the District of Columbia.

WITNESSES

SEC. 908. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] For the efficient administration of the functions vested in the Board or any division thereof, any member of the Board, or any employee of the Board designated in writing for the purpose by the chairman, may administer oaths, and any member of the Board may examine witnesses and require, by subpœna ordered by the Board or any division thereof and signed by the member, (1) the attendance and testimony of witnesses, and the production of all necessary returns, books, papers, documents, correspondence, and other evidence, from any place in the United States at any designated place of hearing, or (2) the taking of a deposition before any designated individual competent to administer oaths under this Act. In the case of a deposition the testimony shall be reduced to writing by the individual taking the deposition or under his direction and shall then be subscribed by the deponent.

SEC. 909. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] (a) Any witness summoned or whose deposition is taken under section 908 shall receive the same fees and mileage as witnesses in courts of the United States. Such fees and mileage and the expenses of taking any such deposition shall be paid as follows:

(1) In the case of witnesses for the Commissioner, such payments shall be made by the Secretary out of any moneys appropriated for the collection of internal-revenue taxes, and may be made in advance.

(2) In the case of any other witnesses, such payments shall be made, subject to rules prescribed by the Board, by the party at whose instance the witness appears or the deposition is taken.

(b) This section shall take effect as of June 2, 1924, in the case of fees, mileage, or expenses accrued prior to, but remaining unpaid at the time of, the enactment of the Revenue Act of 1926.

EXPENDITURES AND PERSONNEL

SEC. 910. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] The members of the Board shall receive necessary traveling expenses, and expenses actually incurred for subsistence while traveling on duty and away from their designated stations, subject to the same limitations in amount as are now or may hereafter be applicable to the Board of General Appraisers. The employees of the Board shall receive their necessary traveling expenses, and expenses actually incurred for subsistence while traveling on duty and away from their designated stations, in an amount not to exceed $5 per day. The Board is authorized in accordance with the civil service laws to appoint, and in accordance with the Classification Act of 1923 to fix the compensation of, such employees, and to make such expenditures (including expenditures for personal services and rent at the seat of Government and elsewhere, and for law books, books of reference, and periodicals), as may be necessary efficiently to execute the functions vested in the Board. All expenditures of the Board shall be allowed and paid, out of any moneys appropriated for the purposes of the Board, upon presentation of itemized vouchers therefor

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signed by the chairman. All fees received by the Board shall be covered into the Treasury as miscellaneous receipts. Section 3709 of the Revised Statutes of the United States shall not be construed to apply to any purchase or service rendered for the Board when the aggregate amount involved does not exceed the sum of $25.

FRIVOLOUS APPEALS TO BOARD

SEC. 911. [*Revenue Act of 1924, as amended by section 1000, Revenue Act of 1926.*] Whenever it appears to the Board that proceedings before it have been instituted by the taxpayer merely for delay, damages in an amount not in excess of $500 shall be awarded to the United States by the Board in its decision. Damages so awarded shall be assessed at the same time as the deficiency and shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax.

TRANSFEREE PROCEEDINGS

SEC. 912. [*Revenue Act of 1924, added by section 602, Revenue Act of 1928.*] In proceedings before the Board the burden of proof shall be upon the Commissioner to show that a petitioner is liable as a transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax.

SEC. 913. [*Revenue Act of 1924, added by section 602, Revenue Act of 1928.*] Upon application to the Board, a transferee of property of a taxpayer shall be entitled, under rules prescribed by the Board, to a preliminary examination of books, papers, documents, correspondence, and other evidence of the taxpayer or a preceding transferee of the taxpayer's property, if the transferee making the application is a petitioner before the Board for the redetermination of his liability in respect of the tax (including interest, penalties, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer. Upon such application the Board may require by subpœna, ordered by the Board or any division thereof and signed by a member, the production of all such books, papers, documents, correspondence, and other evidence within the United States the production of which, in the opinion of the Board or division thereof, is necessary to enable the transferee to ascertain the liability of the taxpayer or preceding transferee and will not result in undue hardship to the taxpayer or preceding transferee. Such examination shall be had at such time and place as may be designated in the subpœna.

REVISED STATUTES

SEC. 989. [*Revised Statutes.*] When a recovery is had in any suit or proceeding against a collector or other officer of the revenue for any act done by him, or for the recovery of any money exacted by or paid to him and by him paid into the Treasury, in the performance of his official duty, and the court certifies that there was probable cause for the act done by the collector or other officer, or that he acted under the directions of the Secretary of the Treasury, or other proper officer of the Government, no execution shall issue against such collector or other

officer, but the amount so recovered shall, upon final judgment, be provided for and paid out of the proper appropriation from the Treasury.

SEC. 3164. [*Revised Statutes, as amended, and reenacted without change by section 1115, Revenue Act of 1926.*] It shall be the duty of every collector of internal revenue having knowledge of any willful violation of any law of the United States relating to the revenue, within thirty days after coming into possession of such knowledge, to file with the district attorney of the district in which any fine, penalty, or forfeiture may be incurred, a statement of all the facts and circumstances of the case within his knowledge, together with the names of the witnesses, setting forth the provisions of law believed to be so violated on which reliance may be had for condemnation or conviction.

SEC. 3165. [*Revised Statutes, as amended, and reenacted without change by section 1115, Revenue Act of 1926.*] Every collector, deputy collector, internal-revenue agent, and internal-revenue officer assigned to duty under an internal-revenue agent, is authorized to administer oaths and to take evidence touching any part of the administration of the internal-revenue laws with which he is charged, or where such oaths and evidence are authorized by law or regulation authorized by law to be taken.

SEC. 3167. [*Revised Statutes, as amended, and reenacted without change by section 1115, Revenue Act of 1926.*] It shall be unlawful for any collector, deputy collector, agent, clerk, or other officer or employee of the United States to divulge or to make known in any manner whatever not provided by law to any person the operations, style of work, or apparatus of any manufacturer or producer visited by him in the discharge of his official duties, or the amount or source of income, profits, losses, expenditures, or any particular thereof, set forth or disclosed in any income return, or to permit any income return or copy thereof or any book containing any abstract or particulars thereof to be seen or examined by any person except as provided by law; and it shall be unlawful for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures appearing in any income return; and any offense against the foregoing provision shall be a misdemeanor and be punished by a fine not exceeding $1,000 or by imprisonment not exceeding one year, or both, at the discretion of the court; and if the offender be an officer or employee of the United States he shall be dismissed from office or discharged from employement.

SEC. 3172. [*Revised Statutes, as amended, and reenacted without change by section 1115, Revenue Act of 1926.*] Every collector shall, from time to time, cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal-revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumerate said objects.

SEC. 3173. [*Revised Statutes, as amended, and reenacted without change by section 1115, Revenue Act of 1926.*] It shall be the duty of any person, partnership, firm, association, or corporation, made liable

to any duty, special tax, or other tax imposed by law, when not otherwise provided for, (1) in case of a special tax, on or before the thirty-first day of July in each year, and (2) in other cases before the day on which the taxes accrue, to make a list or return, verified by oath, to the collector or a deputy collector of the district where located, of the articles or objects, including the quantity of goods, wares, and merchandise, made or sold and charged with a tax, the several rates and aggregate amount, according to the forms and regulations to be prescribed by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, for which such person, partnership, firm, association, or corporation is liable: *Provided*, That if any person liable to pay any duty or tax, or owing, possessing, or having the care or management of property, goods, wares, and merchandise, article or objects liable to pay any duty, tax, or license, shall fail to make and exhibit a list or return required by law, but shall consent to disclose the particulars of any and all the property, goods, wares, and merchandise, articles, and objects liable to pay any duty or tax, or any business or occupation liable to pay any tax as aforesaid, then, and in that case, it shall be the duty of the collector or deputy collector to make such list or return, which, being distinctly read, consented to, and signed and verified by oath by the person so owning, possessing, or having the care and management as aforesaid, may be received as the list of such person: *Provided further*, That in case no annual list or return has been rendered by such person to the collector or deputy collector as required by law, and the person shall be absent from his or her residence or place of business at the time the collector or a deputy collector shall call for the annual list or return, it shall be the duty of such collector or deputy collector to leave at such place of residence or business, with some one of suitable age and discretion, if such be present, otherwise to deposit in the nearest post office, a note or memorandum addressed to such person, requiring him or her to render to such collector or deputy collector the list or return required by law within ten days from the date of such note or memorandum, verified by oath. And if any person, on being notified or required as aforesaid, shall refuse or neglect to render such list or return within the time required as aforesaid, or whenever any person who is required to deliver a monthly or other return of objects subject to tax fails to do so at the time required, or delivers any return which, in the opinion of the collector, is erroneous, false, or fraudulent, or contains any undervaluation or understatement, or refuses to allow any regularly authorized Government officer to examine the books of such person, firm, or corporation, it shall be lawful for the collector to summon such person, or any other person having possession, custody, or care of books of account containing entries relating to the business of such person or any other person he may deem proper, to appear before him and produce such books at a time and place named in the summons, and to give testimony or answer interrogatories, under oath, respecting any objects or income liable to tax or the returns thereof. The collector may summon any person residing or found within the State or Territory in which his district

lies; and when the person intended to be summoned does not reside and can not be found within such State or Territory, he may enter any collection district where such person may be found and there make the examination herein authorized. And to this end he may there exercise all the authority which he might lawfully exercise in the district for which he was commissioned: *Provided*, That "person," as used in this section, shall be construed to include any corporation, joint-stock company or association, or insurance company when such construction is necessary to carry out its provisions.

SEC. 3176. [*Revised Statutes, as amended by section 1103, Revenue Act of 1926, and further amended by section 619, Revenue Act of 1928.*] If any person, corporation, company, or association fails to make and file a return or list at the time prescribed by law or by regulation made under authority of law, or makes, willfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise. In any such case the Commissioner of Internal Revenue may, from his own knowledge and from such information as he can obtain through testimony or otherwise, make a return or amend any return made by a collector or deputy collector. Any return or list so made and subscribed by the Commissioner, or by a collector or deputy collector and approved by the Commissioner, shall be prima facie good and sufficient for all legal purposes.

If the failure to file a return (other than a return of income tax) or a list is due to sickness or absence, the collector may allow such further time, not exceeding 30 days, for making and filing the return or list as he deems proper.

The Commissioner of Internal Revenue shall determine and assess all taxes, other than stamp taxes, as to which returns or lists are so made under the provisions of this section. In case of any failure to make and file a return or list within the time prescribed by law, or prescribed by the Commissioner of Internal Revenue or the collector in pursuance of law, the Commissioner shall add to the tax 25 per centum of its amount, except that when a return is filed after such time and it is shown that the failure to file it was due to a reasonable cause and not to willful neglect, no such addition shall be made to the tax. In case a false or fraudulent return or list is willfully made, the Commissioner shall add to the tax 50 per centum of its amount.

The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, falsity, or fraud, in which case the amount so added shall be collected in the same manner as the tax.

SEC. 3186. [*Revised Statutes, as amended, and further amended by section 613, Revenue Act of 1928.*] (a) If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(b) Such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) in accordance with the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law provided for the filing of such notice; or

(2) in the office of the clerk of the United States District Court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law provided for the filing of such notice; or

(3) in the office of the clerk of the Supreme Court of the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(c) Subject to such regulations as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may prescribe, the collector of internal revenue charged with an assessment in respect of any tax—

(1) May issue a certificate of release of the lien if the collector finds that the liability for the amount assessed, together with all interest in respect thereof, has been satisfied or has become unenforceable;

(2) May issue a certificate of release of the lien if there is furnished to the collector and accepted by him a bond that is conditioned upon the payment of the amount assessed, together with all interest in respect thereof, within the time prescribed by law (including any extension of such time), and that is in accordance with such requirements relating to terms, conditions, and form of the bond and sureties thereon, as may be specified in the regulations;

(3) May issue a certificate of partial discharge of any part of the property subject to the lien if the collector finds that the fair market value of that part of such property remaining subject to the lien is at least double the amount of the liability remaining unsatisfied in respect of such tax and the amount of all prior liens upon such property.

(d) A certificate of release or of partial discharge issued under this section shall be held conclusive that the lien upon the property covered by the certificate is extinguished.

(e) The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may by regulation provide for the acceptance of a single bond complying both with the requirements of section 272 (j) of the Revenue Act of 1928 (relating to the extension of time for the payment of a deficiency), or of any similar provisions of any prior law, and the requirements of subsection (c) of this section.

(f) Subsections (c), (d), and (e) of this section shall apply to a lien in respect of any internal-revenue tax, whether or not the lien is imposed by this section.

SEC. 3195. [*Revised Statutes, as amended, and reenacted without change by section 1128, Revenue Act of 1926.*] When any property liable to distraint for taxes is not divisible, so as to enable the collector by sale of a part thereof to raise the whole amount of the tax, with all costs and charges, the whole of such property shall be sold, and the surplus of the proceeds of the sale, after making allowance for the amount of the tax, interest, penalties, and additions thereto, and for the costs and charges of the distraint and sale, shall be deposited with the Treasurer of the United States as provided in subdivision (b) of section 3210.

SEC. 3200. [*Revised Statutes, as amended by section 1129, Revenue Act of 1926.*] Any collector or deputy collector may, for the collection of taxes imposed upon any person, and committed to him for collection, seize and sell any of the property, real or personal (except property exempt from distraint and sale, under section 3187 of the Revised Statutes), or any right or interest therein, of such person situated in any other collection district within the State in which such officer resides, notwithstanding the provisions of section 3209 of the Revised Statutes; and his proceedings in relation thereto shall have the same effect as if the same were had in his proper collection district.

SEC. 3207. [*Revised Statutes, as amended, and reenacted without change by section 1127, Revenue Act of 1926.*] (a) In any case where there has been a refusal or neglect to pay any tax, and it has become necessary to seize and sell real estate to satisfy the same, the Commissioner of Internal Revenue may direct a bill in chancery to be filed, in a district court of the United States, to enforce the lien of the United States for tax upon any real estate, or to subject any real estate owned by the delinquent, or in which he has any right, title, or interest, to the payment of such tax. All persons having liens upon or claiming any interest in the real estate sought to be subjected as aforesaid, shall be made parties to such proceedings, and be brought into court as provided in other suits in chancery therein. And the said court shall, at the term next after the parties have been duly notified of the proceedings, unless otherwise ordered by the court, proceed to adjudicate all matters involved therein, and finally determine the merits of all claims to and liens upon the real estate in question, and, in all cases where a claim or interest of the United States therein is established, shall decree a sale of such real estate, by the proper officer of the court, and a distribution of the proceeds of such sale according to the findings of the court in respect to the interests of the parties and of the United States.

(b) Any person having a lien upon or any interest in such real estate, notice of which has been duly filed of record in the jurisdiction in which the real estate is located, prior to the filing of notice of the lien of the United States as provided by section 3186 of the Revised Statutes as amended, or any person purchasing the real estate at a sale to satisfy such prior lien or interest, may make written request to the Commissioner of Internal Revenue to direct the filing of a bill in chancery as provided in subdivision (a), and if the Commissioner fails to direct the filing of such bill within six months after receipt of such written request, such person or purchaser may, after giving

notice to the Commissioner, file a petition in the district court of the United States for the district in which the real estate is located, praying leave to file a bill for a final determination of all claims to or liens upon the real estate in question. After a full hearing in open court, the district court may in its discretion enter an order granting leave to file such bill, in which the United States and all persons having liens upon or claiming any interest in the real estate shall be made parties. Service on the United States shall be had in the manner provided by sections 5 and 6 of the Act of March 3, 1887, entitled "An Act to provide for the bringing of suits against the Government of the United States." Upon the filing of such bill the district court shall proceed to adjudicate the matters involved therein, in the same manner as in the case of bills filed under subdivision (a) of this section. For the purpose of such adjudication, the assessment of the tax upon which the lien of the United States is based shall be conclusively presumed to be valid, and all costs of the proceedings on the petition and the bill shall be borne by the person filing the bill.

SEC. 3210. [*Revised Statutes, as amended, and reenacted without change by section 1128, Revenue Act of 1926.*] (a) Except as provided in subdivision (b) the gross amount of all taxes and revenues received under the provisions of this Act, and collections of whatever nature received or collected by authority of any internal-revenue law, shall be paid daily into the Treasury of the United States under instructions of the Secretary of the Treasury as internal-revenue collections, by the officer receiving or collecting the same, without any abatement or deduction on account of salary, compensation, fees, costs, charges, expenses, or claims of any description. A certificate of such payment, stating the name of the depositor and the specific account on which the deposit was made, signed by the treasurer, assistant treasurer, designated depositary, or proper officer of a deposit bank, shall be transmitted to the Commissioner of Internal Revenue.

(b) Sums offered in compromise under the provisions of section 3229 of the Revised Statutes and section 35 of Title II of the National Prohibition Act, sums offered for the purchase of real estate under the provisions of section 3208 of the Revised Statutes, and surplus proceeds in any distraint sale, after making allowance for the amount of the tax, interest, penalties, and additions thereto, and for costs and charges of the distraint and sale, shall be deposited with the Treasurer of the United States in a special deposit account in the name of the collector making the deposit. Upon acceptance of such offer in compromise or offer for the purchase of such real estate, the amount so accepted shall be withdrawn by the collector from his special deposit account with the Treasurer of the United States and deposited in the Treasury of the United States as internal-revenue collections. Upon the rejection of any such offer, the Commissioner shall authorize the collector, through whom the amount of such offer was submitted, to refund to the maker of such offer the amount thereof. In the case of surplus proceeds from distraint sales the Commissioner shall, upon application and satisfactory proof in support thereof, authorize the collector through whom

the amount was received to refund the same to the person or persons legally entitled thereto.

SEC. 3214. [*Revised Statutes.*] No suit for the recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Commissioner of Internal Revenue authorizes or sanctions the proceedings: *Provided*, That in case of any suit for penalties or forfeitures brought upon information received from any person, other than a collector or deputy collector, the United States shall not be subject to any costs of suit.

SEC. 3218. [*Revised Statutes.*] Every collector shall be charged with the whole amount of taxes, whether contained in lists transmitted to him by the Commissioner of Internal Revenue, or by other collectors, or delivered to him by his predecessor in office, and with the additions thereto, with the par value of all stamps deposited with him, and with all moneys collected for penalties, forfeitures, fees, or costs; and he shall be credited with all payments into the Treasury made as provided by law, with all stamps returned by him uncanceled to the Treasury, and with the amount of taxes contained in the lists transmitted in the manner heretofore provided to other collectors, and by them receipted as aforesaid; also with the amount of the taxes of such persons as may have absconded, or become insolvent, prior to the day when the tax ought, according to the provisions of law, to have been collected, and with all uncollected taxes transferred by him or by his deputy acting as collector to his successor in office: *Provided*, That it shall be proved to the satisfaction of the Commissioner of Internal Revenue, who shall certify the facts to the (First) Comptroller of the Treasury, that due diligence was used by the collector. And each collector shall also be credited with the amount of all property purchased by him for the use of the United States, provided he faithfully account for and pay over the proceeds thereof upon a resale of the same as required by law.

SEC. 3224. [*Revised Statutes.*] No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

SEC. 3226. [*Revised Statutes, as amended, and reenacted without change by section 1113, Revenue Act of 1926.*] No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from

the date of the payment of such tax, penalty, or sum, unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The Commissioner shall within 90 days after any such disallowance notify the taxpayer thereof by mail.

SEC. 3229. [*Revised Statutes.*] The Commissioner of Internal Revenue, with the advice and consent of the Secretary of the Treasury, may compromise any civil or criminal case arising under the internal-revenue laws instead of commencing suit thereon; and, with the advice and consent of the said Secretary and the recommendation of the Attorney General, he may compromise any such case after a suit thereon has been commenced. Whenever a compromise is made in any case there shall be placed on file in the office of the Commissioner the opinion of the Solicitor of Internal Revenue, or of the officer acting as such, with his reasons therefor, with a statement of the amount of tax assessed, the amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and the amount actually paid in accordance with the terms of the compromise.

SEC. 3466. [*Revised Statutes.*] Wherever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

SEC. 3467. [*Revised Statutes.*] Every executor, administrator, or assignee, or other person, who pays any debt due by the person or estate from whom or for which he acts, before he satisfies and pays the debts due to the United States from such person or estate, shall become answerable in his own person and estate for the debts due to the United States, or for so much thereof as may remain due and unpaid.

SEC. 3477. [*Revised Statutes.*] All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interests therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertaining of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney, must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgments of deeds, and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgment, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same.

INDEX—APPENDIX

[References are to sections of the Revenue Act of 1926, the Revenue Act of 1924, and the Revised Statutes, indicated respectively by "(1926)," "(1924)," and "(R. S.)"; and to articles (indicated in italics) of Regulations 75. For index to Regulations 74, see pages 373–422]

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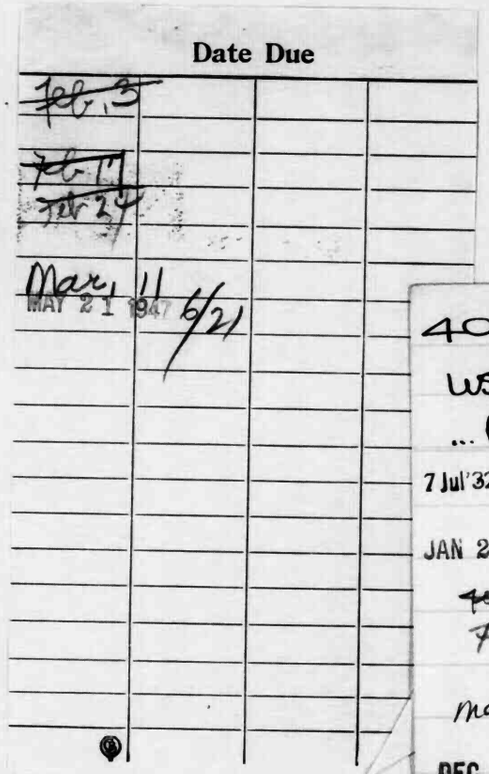

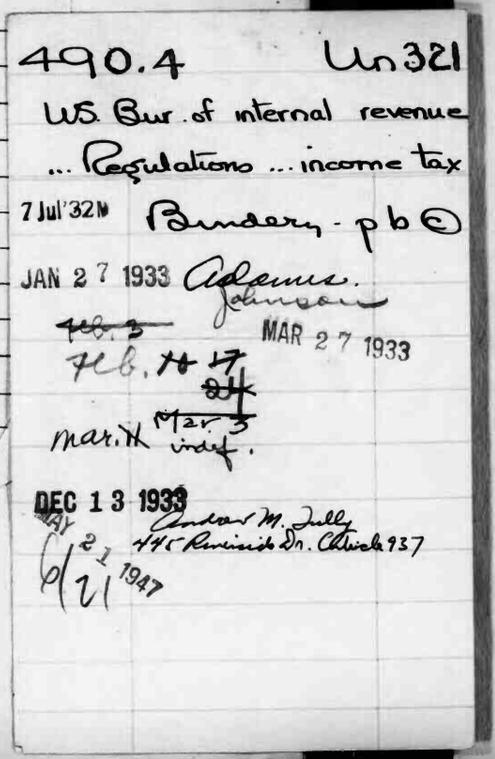

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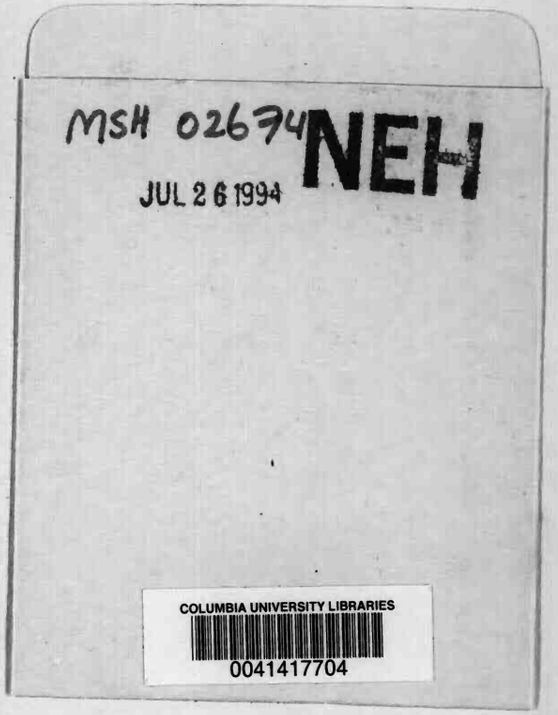

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